CASES DECIDED
IN

# THE UNITED STATES COURT OF CLAIMS

November 1, 1976 to January 31, 1977

WITH

## REPORT OF DECISIONS OF THE SUPREME COURT IN COURT OF CLAIMS CASES

REPORTED BY
AUDREY BERNHARDT
REPORTER

VOLUME 212

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1977

---

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

Stock No. 028-000-00056-1

KJT 8931
A2
v.212

Parallel citations to the Federal Reporter System are given at the top of each case reported herein to the extent that such citations are available at the time of publication. Not all Court of Claims decisions are reported in the Federal Reporter System, but if no parallel citation is indicated it is suggested that the reader check to determine whether the case may have been subsequently reported.

---

The Key Number Classification and Symbol embodied in these Reports are used under license of the copyright owner.

Vol. 212

COURT OF CLAIMS REPORTS

# E R R A T A

Please make the following corrections:

Page XIII - Title 41, § 322 - Add to last line:

"Sperry Flight Systems; Varo, Inc.; Wickham Contracting Co."

Page 2 - line 12 - Change the second word "with" to "without"

Page 206, note 4, line 1 - Change "significant" to "significance"

Page 229 - the second line from the bottom should read:

"among possible alternatives, in the Renegotiation context, we"

Page 591, line 11 - correct spelling of "certiorari"

# CONTENTS

1. JUDGES AND OFFICERS OF THE COURT
2. ASSISTANT ATTORNEYS GENERAL CHARGED WITH THE DEFENSE OF THE GOVERNMENT
3. TABLE OF CASES REPORTED
4. TABLE OF STATUTES CITED AND RULES OF THE COURT CITED
5. DESIGNATION OF A JUDGE FOR SERVICE IN ANOTHER COURT
6. OPINIONS OF THE COURT
7. CONGRESSIONAL REFERENCE CASES
8. ORDERS
9. JUDGMENT ORDERS
10. REPORT OF SUPREME COURT DECISIONS
11. TOPICAL INDEX
12. TWELFTH SUPPLEMENTARY INDEX OF COURT OF CLAIMS CASES, VOLUMES 201–210, INCLUSIVE

## ASSISTANT ATTORNEYS GENERAL

(Charged with the defense of the Government)

NOVEMBER 1, 1976 to JANUARY 31, 1977

PETER R. TAFT
Land and Natural Resources Division

SCOTT P. CRAMPTON
(November 1 to November 30, 1976)

MYRON C. BAUM
Acting Assistant Attorney General
(December 1, 1976 to January 31, 1977)
Tax Division

REX E. LEE
(November 1, 1976 to January 20, 1977)

IRVING JAFFE
Acting Assistant Attorney General
(January 20 to January 31, 1977)
Civil Division

# TABLE OF CASES REPORTED


| | Page. |
|---|---|
| ABBOTT, RUSSELL J., ET AL | 562 |
| ADAMS, CLIFFORD B | 531 |
| AEROJET-GENERAL CORP | 526 |
| AMERICAN DREDGING CO | 582 |
| AMERICAN PRESIDENT LINES, LTD | 574 |
| ANDREWS, JOSEPH, ET AL | 573 |
| AUTOGIRO COMPANY OF AMERICA (SEE PITCAIRN, STEPHEN) | 168 |
| BASIC INC | 399 |
| BAUER, ELDON E | 599 |
| BECK, HAROLD | 99 |
| BELL, JASPER, ET AL | 573 |
| BENENSON, CHARLES B., ET AL | 375 |
| BENNETT, JOSEPH E., CO | 567 |
| BOURGEOIS, MAE | 32 |
| CENTRAL STATES HEALTH & LIFE CO | 588 |
| CLARK, WARDELL F | 590 |
| COASTAL PETROLEUM CO | 548 |
| COHEN, LEVI | 568 |
| COMPREHENSIVE DESIGNERS, INC | 88 |
| CONFEDERATED SALISH AND KOOTENAI TRIBES | 587 |
| CONLEY, LENA ROSA K | 561 |
| CRAIGLOW, RICHARD C., ET AL | 542 |
| CRILE, D. MICHAEL, ET AL | 47 |
| CUNNINGHAM, KATHERINE | 451 |
| CUSHING STONE CO | 599 |
| DIZ LIVESTOCK CO., ET AL | 601 |
| DYNALECTRON CORP | 118 |
| EASTMAN KODAK CO | 599 |
| EXXON CORP | 258 |
| FEC LIQUIDATING CORP | 345 |
| FINN, DON W | 353 |

# TABLE OF STATUTES CITED
## (By Case Name)

### STATUTES AT LARGE

1856, May 14; ch. 207, 11 Stat. 8; Bourgeois
1930, May 29; ch. 349, 46 Stat. 476; Gentry
1931, Feb. 26; ch. 307, 46 Stat. 1421; Pitcairn
1934, June 27; ch. 847, 48 Stat. 1252; Lindy
1942, Oct. 31, ch. 634, 56 Stat. 1013; Pitcairn
1947, July 18; 61 Stat. 3301; Kabua
1948, Feb. 28; ch. 84, 62 Stat. 54; Gentry
1954, May 11; ch. 199, 68 Stat. 81; Wickam Contracting Co.
1956, July 31; ch. 804, 70 Stat. 744; Gentry
1965, June 21; 79 Stat. 145; Peninsula Motor Club
1966, July 18; 80 Stat. 300; Gentry
1972, Aug. 29, 86 Stat. 652; Cunningham; First Nat'l City Bank; Joseph E. Bennett Co.
1972, Oct. 25, 86 Stat. 1176; Bourgeois
1972, Oct. 27; 86 Stat. 1272; Benenson
1973, Dec. 14; 87 Stat. 705; Ryan
1974, Oct. 1; 88 Stat. 1170; Benenson
1975, Jan. 2; 88 Stat. 1926; Pitcairn
1975, Jan. 3; 88 Stat. 2108; Pitcairn
1976, Feb. 5; 90 Stat. 119 et seq.; Shovlin; Trainer
1976, Aug. 14; 90 Stat. 1188; Benenson.

### UNITED STATES CODE

Title 5:
§ 304; American Dredging Co.
§ 552(b)(3) & (4); Instrument Systems Corp.
§ 2251(j)(2)(1964); Gentry
§§ 5101 et seq., 5596; Gentry
§§ 6304 (1970), 6304(d)(1)B (Supp. V, 1975); Ryan
§ 8116(a) (Supp. V, 1975); Cunningham
§§ 8331 et seq., 8341(a)(3)(A)(ii), 8341(e), 8347(b) & (c); Gentry
Title 10:
§ 681(a); Adams
§ 1201; Finn
§ 1552; Cunningham
§ 2304; Gibraltar Mfg. Co.
§ 2306(f); Aerojet-General Corp.; Sperry Flight Systems

Title 12:
§ 1713(d); Lindy
Title 16:
§§ 79a–79j, 79c(b)(2); Pitcairn
§§ 461 et seq.; Benenson
Title 25:
§§ 70 et seq.; Kabua
Title 26:
§ 263(a) & (c); Exxon Corp.
§ 337; FEC Liquidating Corp.
§ 355; Versitron, Inc.
§§ 361, 368(a)(1)(C), (D) & (F); FEC Liquidating Corp.
§ 368(a)(1)(A), (a)(2)(B) & (C); Versitron, Inc.
§ 461(a); Inland Steel Co.
§§ 1371–79; Versitron, Inc.
§§ 1401–03; Guerard
§§ 2036(b), 2038(a)(2), 2041; Crile
§ 2056; Stubbs
§§ 6401, 6402, 6501; Guerard
§ 6511; World Instruction & Translation Co.
§§ 6511(b)(2), 6513(b)(1) & (d)(1); Craiglow
§§ 6601(a) & (f)(3); Hart Metal Prod. Corp.
§ 7422; World Instruction & Translation Co.; 7422(a); Inland Steel Co.
Title 28:
§ 293(a); Pitcairn
§ 1346(f) (Supp. V, 1975); Bourgeois
§ 1361; Cunningham
§ 1406(c); Minot
§ 1491; American President Lines; Bourgeois; First Nat'l City Bank; Huerta; Kabua; Morton
§ 1491 (Supp. V, 1975); Cunningham; Gentry; Joseph E. Bennett Co.
§ 1492; Yarnall (Cong. Ref.)
§ 1498; Pitcairn
§ 1502; Kabua
§ 1506; Bourgeois; Morton
§ 2201; Gentry
§ 2409a(f) (Supp. V, 1975); Bourgeois
§ 2415(f); Simmonds Precision Products
§ 2501; Bourgeois; Hinojosa; Huerta; Kabua; Yarnall (Cong. Ref.)
§ 2502; Huerta; Truong Xuan Truc
§ 2505; Pitcairn
§ 2509; Yarnall (Cong. Ref.)
§ 2516; First Nat'l City Bank
§ 2521; American Dredging Co.
Title 31:
§ 203; First Nat'l City Bank

Title 35:
§§ 89–96 (1946), § 284 (1952); Pitcairn
Title 38:
§ 211(a); Cunningham; Powers
§§ 301 et seq.; Cunningham
§ 3010(i); Powers
Title 40:
§ 121; Benenson
§ 258a; Pitcairn
§§ 871 et seq., 872(b), 875(6), 876 (Supp. V, 1975); Benenson

Title 41:
§ 15; First Nat'l City Bank
§ 321; Dynalectron Corp.; Simmonds Precision Products, Inc.; S.O.G. of Arkansas; Sperry Flight Systems; Varo, Inc.; Wickham Contracting Co.
Sperry Flight Systems; Varo, Inc.; Wickham Contracting Co.
§ 322; Dynalectron Corp.; Holtzen Constr. Co.; Robert L. Guyler Co.; Simmonds Precision Products, Inc.; S.O.G. of Arkansas;

Title 42:
§ 402(d)(1) & (3); Gentry
§ 405; Guerard
§ 416(h)(2) & (h)(3)(B); Gentry
§§ 2000e et seq.; Williams

Title 45:
§§ 701 et seq. (as amended 2/5/76); Shovlin; Trainer

Title 46:
§§ 1171 et seq., 1176; American President Lines

Title 50 App.:
§§ 1211 et seq.; Comprehensive Designers; Instrument Systems Corp.; Marinette Marine Corp.
§§ 1211–24, 1212–18; Gibraltar Mfg. Co.
§ 1213(e)(1), (4) & (5); Gibraltar Mfg. Co.; 1213(g); Comprehensive Designers
§ 1215(a); Comprehensive Designers
§ 1218 (Supp. V, 1975); Gentry

INTERNAL REVENUE CODE OF 1954

§ 172; Peninsula Motor Club
§§ 243(a)(1), 301(d)(3), 316(a)(1), 334(b)(2); Basic Inc.
§ 456(a), (e)(1), (2) & (3); Peninsula Motor Club
§§ 531, 532, 533, 535, 537, 551–58; John B. Lambert & Assoc.
§ 4242(a) & (b); Peninsula Motor Club

PRESIDENTIAL PROCLAMATION

No. 3447, dated February 3, 1962; Huerta

RULES OF THE COURT CITED (1969 EDITION)
(as amended)

7(d); Bourgeois, Gentry, S.O.G. of Arkansas
12, 13; Short
39(a), (b); Cunningham
40(a); Simmonds Precision Products
41(a)(1); First Nat'l City Bank, Minot; (1) & (2); Coastal Petroleum Co.
53(c)(2)(i); Short; (i) & (ii); Instrument Systems; Marinette Marine Corp.
54; Short
71(b)(1); Marinette Marine Corp.; (b)(1) & (f); Instrument Systems
81, 82(a); American Dredging Co.
101(b) Short; (d) Gentry; (f); Gentry; Higgs
102(a)(1)(iii); Hart Metal Products Corp.; Stubbs; (e); Central States Co.
112; Short
123(b)(1); American Dredging Co.
131(c); Cunningham; Exxon Corp.; Gibraltar Mfg. Co.; Pitcairn; Tristate Developers
134(b); Abbott; Fisackerly; (h); Pitcairn
141; Fisackerly; (b); John B. Lambert & Assoc.
142, 143(b); Fisackerly
149; American President Lines; Joseph E. Bennett Co.; SCM Corp.; (f); Gentry
150; American President Lines; Gentry
151; Bourgeois; Gentry; (b); S.O.G. of Arkansas
163(b); Truong Xuan Truc
166(c); John B. Lambert & Assoc.; Simmonds Precision Products; Truong Xuan Truc; Varo, Inc.; Wickham Constr. Co.
203(c); Truong Xuan Truc

## DESIGNATION OF A JUDGE OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN ANOTHER CIRCUIT

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, designated and assigned the Honorable Robert L. Kunzig, a Judge of the United States Court of Claims, to act as a Circuit Judge of the United States Court of Appeals for the Ninth Circuit for the period January 6 and 7, 1977, and for such additional time in advance thereof to prepare for the trial of cases or thereafter as may be required to complete unfinished business.

# CASES DECIDED

## IN

## THE UNITED STATES COURT OF CLAIMS

NOVEMBER 1, 1976 TO JANUARY 31, 1977 AND OTHER CASES NOT HERETOFORE PUBLISHED

---

546 F. 2d 343

## GERALD E. GENTRY, AN INFANT OVER THE AGE OF 14 YEARS, BY EUNICE BRADFORD, HIS GUARDIAN AD LITEM v. THE UNITED STATES

[No. 312-74. Decided November 17, 1976]*

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; Civil Service Retirement Act; survivor annuities; illegitimate child; Court of Claims jurisdiction; severability and constitutionality of live-with requirement.**—Plaintiff, an illegitimate minor child, seeks survivor annuity benefits under the Civil Service Retirement Act of 1930, as amended, as the survivor of his alleged deceased father, a retired Government employee. The Civil Service Commission denied the claim solely because plaintiff did not live in the annuitant's home "in a regular parent-child relationship." Defendant has attacked this court's jurisdiction because the claim is not one for money presently due and owing, contending that the annuity statute, since it expressly excludes plaintiff from its coverage by virtue of the live-with requirement cannot be read to provide for payment of benefits to plaintiff. Defendant also contends that plaintiff failed to exhaust administrative remedies in that he failed to present his case to the Commission's Appeals Review Board. Plaintiff contends that the live-with language is void as unconstitutional and that the remaining provisions of the statute specify payment of the claimed benefits. It is *held* (1) that the court has jurisdiction

*See order of April 1, 1977, *post* at 27, on defendant's motion for rehearing *en banc*.



242-469—78——2

Syllabus

because the live-with requirement is severable from its statutory context; (2) that, under the circumstances here, the court may take cognizance of the claim despite plaintiff's failure to make a formal presentation of it to the Appeals Review Board, and that defendant was not prejudiced by that omission; and (3) that in light of the statute's scheme to provide dependency support, the classification barring benefits to the nonresident subclass of illegitimates frustrates the scheme and denies plaintiff due process in violation of the Fifth Amendment; the statute must be construed, and payments made, without regard to the live-with requirement. Defendant's motion for summary judgment is denied, plaintiff's cross-motion is denied with prejudice, since an issue of material fact exists, and the case is remanded to the Commission with instructions to determine whether plaintiff is in fact the child of the deceased annuitant and whether the latter recognized and supported him as such. If plaintiff establishes these requisites to the Commission's satisfaction but it refuses to pay him, plaintiff can return to court for his money judgment.

**Court of Claims jurisdiction; generally.**

[1] Apart from claims based on contract or illegal exactions or retentions of money, the Court of Claims can only render judgment for money when some law can, in itself, fairly be interpreted as prescribing a payment by the United States in the circumstances present.

Courts ⟸ 449(1)

**Statutes; construction and operation; judicial power, scope of.**

[2] If the Court of Claims reads and gives effect to all of a statute that it can without transgressing the oath of loyalty to the Constitution, it is not issuing a declaratory judgment at any time, or otherwise acting prior to judgment to create the entitlement upon which the judgment is based.

Courts ⟸ 470

**Statutes; construction and operation; partial invalidity; effect of.**

[3] The invalid part of a statute may be dropped if what is left is fully operative as a law, unless it is evident that the legislature would not have enacted the statute had the invalid part been omitted.

Statutes ⟸ 64(1)

**Civilian pay; Civil Service Retirement Act; survivor annuities; severability of provisions; Court of Claims jurisdiction.**

[4] From the legislative design and history of the Civil Service Retirement Act of 1930, as amended, as well as the alleged dominant purpose embodied in the statutory scheme of 5 U.S.C. § 8341 to provide financial support for dependent survivors, the live-with requirement relative to an illegitimate child is subordinate in importance to, and independent of, said purpose, and is severable from the remaining provisions of the scheme. Severing the live-with requirement, since the said Act specifies payment of benefits, this court has juris-

1

Syllabus

diction under the Tucker Act to construe the annuity statute to determine whether plaintiff is entitled to survivor benefits.

Statutes ⟸ 64(2)
Courts ⟸ 449(1)

**Civilian pay; administrative remedies; failure to exhaust.**

[5] Where a claimant is not advised of appeal rights, this court may, in its discretion, where the record otherwise warrants it, take jurisdiction notwithstanding a technical failure to exhaust administrative remedies.

Courts ⟸ 448

**Civilian pay; administrative remedies; failure to exhaust; sufficiency of notice of appeal.**

[6] The sufficiency of a notice of administrative appeal should be liberally construed as long as an adverse party is not prejudiced thereby.

Administrative Law and Procedure ⟸ 724

**Civilian pay; administrative remedies; failure to exhaust.**

[7] The futility of pressing a claim excuses the taking of steps otherwise required to exhaust administrative remedies. Thus, since the Civil Service Commission Appeals Review Board, like the Retirement Bureau, had no authority to consider plaintiff's allegation that the live-with provision of 5 U.S.C. § 8341 violates the Constitution, but was bound to read and apply the statutory prohibition as enacted, an administrative appeal would have been futile.

United States ⟸ 39(15)

**Civilian pay; Civil Service Retirement Act; survivor annuities; illegitimate children; spurious claims.**

[8] The statutory bar imposed by 5 U.S.C. § 8341 to payment of civil service annuity benefits to illegitimate children who do not fulfill the live-with requirement is not reasonably related to the prevention of spurious claims. It would not serve the purposes of the Civil Service Retirement Act to conclusively deny such children an opportunity to establish their dependency and their right to the benefits, since the potential of false claims is the same as to both resident and nonresident illegitimates.

United States ⟸ 39(15)

**Constitutional law; due process of law—Fifth Amendment; Civil Service Retirement Act; survivor annuities; illegitimate children.**

[9] Sec. 8341 of Title 5 of the U.S. Code, as part of the statutory scheme of the Civil Service Retirement Act whereby financial support is provided for illegitimate dependent children surviving deceased civil service annuitants, contravenes the due process clause of the Fifth Amendment and equal protection of law guaranteed thereby where the statute conclusively denies to an illegitimate child who did not live with the annuitant annuity benefits which are presumptively available to a resident illegitimate child.

United States ⟸ 39(15)
Constitutional Law ⟸ 238.5, 253(2)

Syllabus

**Constitutional law; due process of law—Fifth Amendment; Civil Service Retirement Act; survivor annuities; classification of beneficiaries; legislative intent.**

[10] In view of the absence of an express dependency requirement in the survivor annuities provisions of 5 U.S.C. § 8341, it is possible that the congressional purpose in enacting these provisions was to extend benefits to surviving members of the immediate family of the annuitant, without regard to dependency. However, a legislative intent to serve administrative convenience by classification, though adequate to support the classification in some circumstances, is impermissible under the due process clause of the Fifth Amendment when that classification amounts to an absolute barrier to the enjoyment, by one subclass of illegitimates by reason of the live-with requirement, of benefits presumptively made available to another subclass of illegitimates.

United States ⟸ 39(15)
Constitutional Law ⟸ 253(2)

**Pleading and practice; summary judgment; when appropriate.**

[11] Although defendant, in its motion for summary judgment, did not contest plaintiff's status as the recognized, supported natural child of the civil service annuitant while otherwise denying the annuitant's alleged paternity support and recognition of plaintiff, where the court, in denying the motion, has determined that an issue of material fact exists as regards plaintiff's status, defendant did not relinquish its right to have judicial consideration of this issue, and as a result since an issue of material fact exists the court is barred from granting plaintiff's cross-motion for summary judgment on its claim for money presently due.

Courts ⟸ 470

**Pleading and practice; remand to Civil Service Commission; when appropriate.**

[12] While, normally, a party's unsupported denial of the opponent's factual allegations do not save the former from the grant of summary judgment in the latter's favor, where the statute under consideration commits to the Civil Service Commission basic factual determinations on which the subject claim turns, the court will not permit a plaintiff to bypass this adminstrative procedure simply by the institution of suit, but will remand the cause to the Commission with appropriate instructions.

Courts ⟸ 466

**Court of Claims jurisdiction; declaratory judgments.**

[13] This court may issue a declaratory judgment only where it is tied and subordinate to a monetary award or where it is explicitly authorized by statute.

Declaratory Judgment ⟸ 274

*Richard A. Weinstock*, attorney of record, for plaintiff.

*Donnie Hoover*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This case comes before the court on the parties' cross-motions for summary judgment on which we have received oral argument. Plaintiff, an illegitimate minor child, asks us by his guardian *ad litem* to award him benefits said to be due him under the Civil Service Retirement Act of 1930, as amended, 5 U.S.C. §§ 8331 *et seq.* (1970), as the survivor of his deceased father, a retired civilian welder for the Navy. The Civil Service Commission's (CSC) Bureau of Retirement, Insurance, and Occupational Health, without deciding whether the deceased civil servant annuitant was the natural father of plaintiff or recognized him as his child, denied plaintiff's claim to survivors' benefits under 5 U.S.C. § 8341 (e) (1970) solely because he did not live in the deceased annuitant's home "in a regular parent-child relationship." The bureau reasoned that the Act (hereafter "annuity statute" or "statute") under which plaintiff claimed required him, as an illegitimate, to have lived with his father in order to be entitled to benefits. 5 U.S.C. § 8341(a)(3)(A)(ii) (1970). Plaintiff now answers that he did not live with his alleged father, but that the "live-with" requirement of the statute must be ignored because the requirement discriminates against illegitimates in violation of the Fifth Amendment to the Constitution and is therefore void, and that the remainder of the statute, read without the offending language, entitles him to survivors' benefits. To decide this matter, we must first consider our authority to resolve the case under the Tucker Act, as recently construed by the Supreme Court in *United States* v. *Testan*, 424 U.S. 392 (1976) (hereafter *Testan*).

## I. *Jurisdiction*

Defendant says that we lack jurisdiction over this suit because it is not a claim for money presently due and owing,

as prescribed by a statute or the Constitution. It bases this argument on *Testan* and *Eastport S.S. Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F. 2d 1002 (1967), in which it was held that (apart from claims based on contract or illegal exactions or retentions of money) this court can only render judgment for money when some law can, in itself, fairly be interpreted as prescribing a payment by the United States in the circumstances present.[1] Defendant argues that no such law exists in this case. The due process clause of the Fifth Amendment is clearly not such a law, nor do we know of any valid regulation promulgated pursuant to statute that prescribes the payment plaintiff asks. Defendant says that the annuity statute, since it expressly excludes plaintiff from its coverage by virtue of the live-with requirement, cannot be read to provide for the payment of benefits to plaintiff. Since plaintiff seeks to avoid this predicament and construct a mandate to pay from the annuity statute's language, he argues, as noted before, that we can order payment on the theory that the live-with language is void as unconstitutional, and that the remaining provisions of the statute specify the payment of his claimed benefits. Thus, we must decide whether we can disregard, on constitutional grounds, one provision of a statute, and render judgment on the provisions that remain standing (if severable).

[1] In *Testan* the Court held that this court was without power to remand to the Civil Service Commission a case in which two civil service attorneys asked reclassification to a higher grade and appropriate back pay. The Court said that our remand power under Pub. L. 92–415, now codified as 28 U.S.C. § 1491 (Supp. V, 1975), extended only to cases otherwise within this court's jurisdiction. Citing heavily *Eastport S.S. Corp.*, the Court ruled that, where "the plaintiff is not suing [the United States] for money improperly exacted or retained, the basis of the federal claim—whether it be the Constitution, a statute, or a regulation—does not create a cause of action for money damages unless, as the Court of Claims has stated, that basis 'in itself * * * can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.'" 424 U.S. at 401–02. Neither the Classification Act, 5 U.S.C. §§ 5101 *et seq.* (1970), nor the Back Pay Act, 5 U.S.C. § 5596 (1970), provided for the payment of such compensation for a wrongful classification, said the Court, and under the Tucker Act, as interpreted in *United States* v. *King*, 395 U.S. 1, 3 (1969), this court has jurisdiction of cases only where the payment of "actual, presently due money damages" is the remedy sought. Accordingly, this court was found without jurisdiction to issue the remand order to the Commission because the claim did not involve *presently* due money damages; indeed, the purpose of the remand order was to allow the Commission to create the entitlement to pay by following a court-directed job comparison that would lead the Commission to conclude that the attorneys' classifications were erroneously low.

Defendant advances two reasons for its view that this decision must be in the negative. First, it says the annuity statute, whether or not the live-with provision is unconstitutional, cannot be understood to require payment of benefits to a nonresident illegitimate child. Of course, this begs the question of severability, for only after inquiring into Congress' intent as to the whole statute can we respond to defendant's assertion.[2] Secondly, and more to the point, it argues that this court, before it can reach the conclusion that the remainder of the statute mandates payments to plaintiff, must first have declared the allegedly offensive language void as against the Fifth Amendment, but that this court may not make such a declaratory judgment, citing *United States* v. *King*, 395 U.S. 1 (1969).

Defendant's second argument is inapt precisely because it misperceives the process of constitutional adjudication. Plaintiff has come before this court, not asking for a declaration of his rights as in *King*, but seeking money allegedly due him. The money claim is grounded, according to plaintiff, on the statute as it now exists—at least when read in light of the Fifth Amendment—and thus states a claim for money presently due, not requiring further action on anyone's part to create the entitlement thereto. This is exactly the kind of claim within our jurisdiction under *Testan*. The issue of the constitutional validity of the live-with requirement arises only incidentally, necessitating an answer by the court in the course of construing the annuity statute to determine whether payment is indeed owing to plaintiff. It is in this fashion that constitutional claims had arisen and been decided in the courts of the United States in the 140 years of their existence before the passage of the Declaratory Judgment Act in 1934, 28 U.S.C. § 2201 (1970). In *United States*

[2] Defendant also argues that plaintiff may not contest the validity of a part of the statutory scheme while claiming benefits under the balance of it, citing Justice Rehnquist's plurality opinion in *Arnett* v. *Kennedy*, 416 U.S. 134, 152–54 (1974). Unlike the appellee in *Arnett*, however, plaintiff can point to no benefits flowing to him alongside the allegedly unconstitutional detriment created by the same statute. In plaintiff's case, either the live-with restriction that he assails is invalid and he can establish qualification for benefits, or the restriction is valid and he is barred from benefits. Plaintiff's claim accordingly falls outside those that the Court has "previously viewed skeptically." 416 U.S. at 152. Defendant's argument on this point, reduced to essentials, amounts to no more than a reworking of its contention on severability, discussed *infra*.

v. *Lovett*, 328 U.S. 303 (1946), the Supreme Court affirmed this court's judgment awarding back pay to federal employees whose salaries had been barred by Act of Congress, in effect discharging them from their jobs. The Court held the Act an unconstitutional bill of attainder, and said the award of pay would lie despite the fact that the Act, the very measure which appropriated funds to pay the employees' salaries, did not authorize payment but sought (unconstitutionally) to stop payment. The Act was construed to provide for paying their salaries, yet this could only be accomplished by reading out of the measure the constitutionally offensive language. The Court stated, 328 U.S. at 314, "[r]espondents claimed that their discharge was unconstitutional; that they consequently rightfully continued to work for the Government and that the Government owes them compensation * * * . Congress has established the Court of Claims to try just such controversies." In the present case, plaintiff asks us to do no more than the Court in *Lovett* said that we could and must do—read the relevant statute and award whatever payment it grants, omitting from our interpretation of its effect any constitutionally void provision contained in it.

Defendant's notion about the sequence of events leading up to a judgment in plaintiff's favor—the reading of the statute barring plaintiff's claim, then the decision that the live-with requirement is unconstitutional, and finally a finding of entitlement based upon a "rewritten" statute—is not founded on any case or rule cited to us, nor is it compelled as a matter of logic. The truth is that this court is bound by oath to read and give effect to the statute, but to do so only with regard to that portion that is constitutional. It is well established that an unconstitutional enactment is void *ab initio*, *Norton* v. *Shelby County*, 118 U.S. 425 (1886), and that judges may not give effect to it. *Younger* v. *Harris*, 401 U.S. 37, 52 (1971). If this court reads and gives effect to all of a statute that it can without transgressing the oath of loyalty to the Constitution, which is what plaintiff asks, it is not issuing a declaratory judgment at any time, or otherwise acting prior to judgment to create the entitlement upon which the judgment is based.

While this court may and indeed must decide whether it can, consistent with the Constitution, give effect to the live-with requirement, in the course of ruling on plaintiff's entitlement under the annuity statute, we must first ask whether the allegedly offending language is severable from the remainder of the statute under which plaintiff claims. Obviously, for plaintiff's claim to succeed, the remaining provisions must be able to stand, giving rise to plaintiff's entitlement to benefits. If the live-with requirement is not separable from the other language of the statute, this court has no jurisdiction to grant recovery to plaintiff, whether the requirement is constitutional or not. If constitutional, the requirement bars plaintiff from the entitled classes, and he can point to no law that authorizes a payment of money to him. If unconstitutional and not separable, the legislative scheme authorizing payment falls, and there is no other law providing for the disbursement of such benefits. Because of the nature of this court's jurisdiction, we must depart from the usual practice of inquiring first into constitutionality and then into severability, and instead consider the latter first. In our view, we have jurisdiction because the allegedly offending requirement is severable from its statutory context.

The question of severability is answered by a practical inquiry into the legislature's intent on the internal relation of the various statutory provisions. " 'Unless it is evident that the legislature would not have enacted those provisions which are within its power, independently of that which is not, the invalid part may be dropped if what is left is fully operative as a law.' " *United States* v. *Jackson*, 390 U.S. 570, 585 (1968), quoting from *Champlin Ref. Co.* v. *Commission*, 286 U.S. 210, 234 (1932). That the live-with requirement is severable from the annuity statute is evident from an analysis of the statute's dominant purpose. Defendant tells us that the purpose of the annuity statute is to provide benefits for survivors dependent or likely to be dependent upon the deceased annuitant. Indeed, so strongly is the legislation concerned, on its face, with the care of surviving dependents that the live-with requirement creates but a minor exception. The exclusion resulting from the requirement is sufficiently minute that it would be absurd to say no part of the legislation would have

been enacted without the requirement. In fact, the legislative history shows that the live-with requirement was enacted well after the purpose of aiding dependents was fixed in the law, apparently as a reaction to a judicial construction of the statute. The 1956 amendments, Act of July 31, 1956, Pub. L. 854, ch. 804, 70 Stat. 744, sought *inter alia* to modify the survivors' benefits provisions introduced by the Act of February 28, 1948, Pub. L. 426, ch. 84, § 11, 62 Stat. 54, amending the Civil Service Retirement Act of May 29, 1930, ch. 349, § 12, 46 Stat. 476. The definition of "child" in the 1948 enactment had been interpreted by a district court to include all illegitimate children. *Visor* v. *United States*, Civ. No. 9922(2) (E.D. Mo., Feb. 12, 1955, unpublished). The effect of adding the live-with requirement to the definition of "child" was to narrow the class of potential beneficiaries.

This sequence of enactment demonstrates the clearly subordinate and, if constitutionally offensive, dispensable position of the live-with requirement. *United States* v. *Jackson*, *supra*, 390 U.S. at 586–91. Further, and very importantly here, the thrust of the 1956 amendments did not vary significantly from the then-existing statutory focus on dependency, retaining the beneficiary status of those illegitimates whom, according to defendant, Congress thought most likely to be dependent, *i.e.*, those living with the annuitant in a regular parent-child relationship at the time of his death. We conclude from the legislative design and history, and the purpose as articulated by defendant, that the live-with requirement is subordinate in importance to, and independent of, the dominant congressional purpose embodied in the statutory scheme, and thus severable from the remaining provisions of the scheme.[3]

Defendant's final challenge to our jurisdiction is based on its allegation that plaintiff failed to exhaust his administrative remedies. Defendant says we should decline to hear this claim at least until after the CSC's Appeals Review Board considers it. Plaintiff has not, it is true, presented his case to that board, as he was entitled to do under 5 C.F.R. § 831.107

[3] The same analysis applies to support a determination of severability where the dominant legislative purpose is that of aiding surviving children, regardless of dependency. See part II, *infra*.

(1974). We note, however, that the Retirement Bureau's first correspondence with plaintiff's mother, denying the benefits claimed by her on plaintiff's behalf, failed to inform of appeal rights. Further, despite this lack of notice, his mother did in fact petition the CSC a second time, asking "review" of the earlier denial. We have previously held that where a claimant is not advised of appeal rights, this court may, in its discretion, where the record otherwise warrants it, take jurisdiction notwithstanding a technical failure to exhaust administrative remedies. *Grover* v. *United States*, 200 Ct. Cl. 337, 346 (1973); *Hagarty* v. *United States*, 196 Ct. Cl. 66, 74, 449 F. 2d 352, 355 (1971). Also, we have held that the "sufficiency of a notice of administrative appeal should be liberally construed as long as an adverse party is not prejudiced thereby." *Pettit* v. *United States*, 203 Ct. Cl. 207, 217, 488 F. 2d 1026, 1031 (1973); *Gernand* v. *United States*, 188 Ct. Cl. 544, 412 F. 2d 1190 (1969). Plaintiff's mother's second communication to the CSC, though directed to the Retirement Bureau instead of the Appeals Review Board, was a sufficient notice to the agency that review of the original adverse action was being sought by the claimant. Indeed, this is the authorized procedure. FPM Supp. 831–1, Subch. S18 (Apr. 30, 1969). Finally, it is significant that the bureau twice based its denial of benefits solely and squarely on the unambiguous language of the annuity statute, barring payments to nonresident illegitimates. Since the board, like the bureau, had no authority to consider an allegation that the live-with provision violates the Constitution, but was bound to read and apply the statutory prohibition as enacted, it is evident that an administrative appeal would have been futile. The futility of pressing a claim excuses the taking of steps otherwise required to exhaust administrative remedies. *Pettit* v. *United States*, *supra*. We conclude from the foregoing that this court may take cognizance of plaintiff's claim despite his failure to make a formal presentation of it to the Appeals Review Board, and also conclude that defendant was not prejudiced by that omission.

Defendant's motion for summary judgment, insofar as it relates to lack of jurisdiction and failure to exhaust administrative remedies, must be denied.

## II. *Constitutionality*

5 U.S.C. § 8341(e) (1970) grants certain monetary benefits to surviving children of a deceased civil service employee or annuitant. The same section defines the entitled children to include legitimate issue, adopted children, and any "stepchild or recognized natural child who lived with the employee * * * in a regular parent-child relationship."[4] 5 U.S.C. § 8341(a)(3)(A)(ii) (1970). The effect of this definition is to extend survivors' benefits to all children of a decedent save for those of his illegitimate issue who did not reside in his home. The latter are conclusively denied benefits under the annuity statute. Thus, children who did not reside with their father during his lifetime are classified at his death according to the legitimacy of their birth, and treated differently on that account: legitimates are paid survivors' benefits, and illegitimates are not. Further, his illegitimate children are classified at his death according to whether they lived with him during his lifetime, and treated differently on that account: illegitimates who resided with him are given benefits, and nonresident illegitimates are denied those same benefits. Plaintiff argues that the annuity statute's definition of "child," insofar as it imposes a live-with requirement upon illegitimates, does not, because of the classification results just described, rationally relate to any permissible legislative goal underlying the statute. Accordingly, he says, the live-with requirement violates the equal protection of the laws as guaranteed to him by the due process clause of the Fifth Amendment. *Jimenez* v. *Weinberger*, 417 U.S. 628, 637 (1974) (hereafter *Jimenez*); *Bolling* v. *Sharpe*, 347 U.S. 497 (1954). Defendant, as already noted, has moved for summary judgment partly on the ground that the requirement is valid and bars plaintiff's claim on the merits. This requires us to decide the constitutional question.

Defendant urges that the statute's definition of "child," excluding nonresident illegitimates, "represents a determination by Congress of those classes of children who were the most probable object of financial support by the parent,

[4] The issues of recognition and support do not confront us now. Plaintiff has alleged they exist and defendant does not contest them for the purposes of the pending motion.

and who are, therefore, most likely to suffer loss of financial support because of his death." Thus, repeating what was said before in the discussion of our jurisdiction, defendant views the support of financially dependent children as a primary purpose of the annuity statute. Defendant also says that a second congressional purpose, the prevention of "spurious claims of parentage," is served by the live-with requirement. Since the statutory scheme as it now stands rationally promotes these legislative goals, defendant argues, it is not vulnerable to attack under the due process clause. The purposes of aiding probable dependents and preventing spurious claims, the only purposes articulated by defendant, were also advanced as the reasons underlying the statutory classification in the *Jimenez* case. There, in support of the classification of children under the disability benefits provisions of the Social Security Act, the Government argued that certain illegitimate children were conclusively denied benefits "because it is 'likely' that these illegitimates, as a class, will not possess the requisite economic dependency on the wage earner which would entitle them to recovery under the Act and because eligibility for such benefits to those illegitimates would open the door to spurious claims." 417 U.S. at 634. Nonetheless, the Court held the classification violative of equal protection under the Fifth Amendment. The similarity of the purposes advanced in support of the statutes' validity, and, as will be seen, the similarity of the two classifications themselves, requires us to examine *Jimenez* closely.

Under the disability benefit provisions at issue in *Jimenez*, a "child" of a disabled insured is entitled to benefits if he is "dependent" upon the insured. 42 U.S.C. § 402(d)(1) (1970). Section 416(h)(2) and (h)(3)(B) of the same title define such child only to include: (1) one considered a child by the intestate succession law for personal property of the insured's state of domicile, (2) one who would otherwise be considered a child but for the fact that the ceremonial marriage of the insured to the child's other parent was invalid for nonobvious defects, (3) one who was acknowledged by the insured in writing or decreed by a court to be the insured's child, or to whom the insured was ordered by a court to contribute support because of parentage, all prior to the beginning of the

disability, and (4) one who was proven to the Secretary of HEW to be the child of the insured, and either living with the insured or supported by him, at the onset of the disability. The effect of this definition is to provide disability benefit payments for the legitimate children of a disabled insured, to his children illegitimate because of a formal defect in his marriage, and to such of his illegitimate children that his state's intestacy law allows to inherit from him. Further, it extends payments to those of his illegitimate children who lived with him, were financially dependent upon him, or were acknowledged by him before his disability began, but it excludes from benefits those illegitimates not included above who were born, or first lived with him, or were first supported by him, or were first acknowledged by him, after the onset of his disability. Hence, for some illegitimates, though never for legitimates or some other illegitimates, timing becomes important to the question of entitlement. Finally, section 402(d)(3) presumes all who fit within the definition of "child" to be dependent, unless the child is illegitimate or adopted by someone else and he neither lived with nor was supported by the insured.

The appellants in *Jimenez* were the disabled insured's illegitimate children, born after the onset of his disability, whom he supported and acknowledged and with whom he lived. The Court found that the appellants' conclusive exclusion from disability benefits by virtue of the statute's definition of "child" was irrational when viewed against the statute's "primary purpose of * * * provid[ing] support for dependents of a disabled wage earner." 417 U.S. at 634. While considering the two purposes of the partial denial of benefits to be permissible in themselves, the Court went on to conclude that the result, excluding the appellants from benefits, did not rationally follow from those purposes. First of all, the Court simply did not accept the Government's assertion that Congress' purpose was to extend aid only to those "most likely" to be dependent. The Court appears to base its rejection of this purpose in part upon the broader rationale—providing support to dependents of a disabled insured—that it saw underlying the statute, and in part upon the legislative scheme itself. As to the latter, its opinion noted that legiti-

mates, legitimated children, illegitimates that state law allowed to inherit from the insured, and children whose illegitimacy resulted from nonobvious defects in the insured's ceremonial marriage, all received benefits (if dependent) even though they were born after the onset of their parent's disability, leading it to conclude that the statute was not designed to make distinctions on the time of birth, or to deny benefits to children born after the disability began. It seems that the Court saw no reason, in giving effect to the purpose of aiding those "most likely" dependent, for drawing a line between some after-born illegitimates, on the one hand, and after-born legitimates and some other after-born illegitimates, on the other hand, denying support payments to the former, while giving them to the latter. Hence, the statutory "means," entailing the partial exclusion of illegitimates, did not measure up to the supposed legislative "end."

The promise of the second purpose, the avoidance of spurious claims, was likewise found unfulfilled in the statute's result. Though not rejecting the Government's assertion that "the possibility that evidence of parentage or support may be fabricated is greater when the child is not born until after the wage earner has become entitled to benefits," the Court reasoned that "[i]t does not follow * * * that the blanket and conclusive exclusion of appellants' subclass of illegitimates is reasonably related to the prevention of spurious claims." Again apparently adverting to the statute's primary purpose, the opinion said "it would not serve the purposes of the Act to conclusively deny them an opportunity to establish their dependency and their right to insurance benefits, * * *." Apart from this failing of the means to further the end, the spurious claims rationale was not in fact promoted by the statute's partial exclusion of illegitimates because "the potential for spurious claims is exactly the same as to both" the covered after-born illegitimates and the excluded after-born illegitimates. 417 U.S. at 636. After observing that the statutory scheme, as it stood, was both overinclusive, extending benefits to legitimates and some illegitimates who were "deemed to be dependent" by 42 U.S.C. § 402(d) even though they were not actually dependent, and underinclusive, presumptively denying benefits

to those in appellants' subclass who may in fact have been dependent, the Court concluded its opinion with the statement:

> * * * for all that is shown in this record, the two subclasses of illegitimates stand on equal footing, and the potential for spurious claims is the same as to both; hence to conclusively deny one subclass benefits presumptively available to the other denies the former the equal protection of the laws * * *. [417 U.S. at 637.]

The Court's objection to the conclusive exclusion of some illegitimates from benefits under a statutory scheme created to aid those financially dependent, particularly where that statute presumptively includes still other illegitimates in the class of those eligible for benefits, states a rule of law that controls the result in the present case. The facts and the nature of the statute in this case do not differ materially from those in *Jimenez*. The legislative purposes articulated by defendant are practically identical to those proffered in *Jimenez*, as set out previously.

Plaintiff, allegedly the illegitimate child of deceased civil service annuitant Leroy Gentry, did not live with the annuitant, in a regular parent-child relationship or otherwise, at any time prior to the annuitant's death. Instead, plaintiff lived with his mother, his guardian *ad litem* here, who had custody of him under local law. Plaintiff's mother says in an affidavit of record that Leroy Gentry's acknowledgment of his paternity of plaintiff can be established in an evidentiary hearing. Hence, plaintiff attacks the constitutionality of only that portion of 5 U.S.C. § 8341(a)(3)(A)(ii) which the CSC said barred him from benefits because he did not live in the annuitant's residence as his child.

The statute in *Jimenez* presumptively extended benefits to supported or resident illegitimates born before the onset of disability, as well as to all legitimates no matter when born, but conclusively denied benefits to illegitimates born after the disability began. The statute in the present case creates a right to survivors' payments in recognized illegitimate children who lived with the annuitant, as well as in all his legitimate children without regard to their residence, but conclusively bars such payments to illegitimates who did not

live with him. Just as in *Jimenez*, where the exclusionary language did not promote the purpose of aiding those most probably dependent, so does the live-with requirement here not rationally follow from that purpose in this case. Here, as much as in *Jimenez*, the provision barring a subclass of illegitimates from benefits, though some members may be dependents, conflicts with the overall aim of aiding dependents. Further, like the case with *Jimenez*, the legislative scheme itself shows that residence with the annuitant is not critical to the qualification for benefits, in that legitimate children may receive payments whether they lived with the annuitant or not. No good reason appears, in light of the purpose of financially assisting those most probably dependent, for differentiating between potentially dependent but nonresident illegitimates, on the one hand, and resident illegitimates along with resident and nonresident legitimates, on the other. The classification of illegitimates, as embodied in the live-with requirement, is not justified by the basic legislative purpose.

The legislative goal of preventing spurious claims of parentage is no more promoted by the live-with requirement than it was by the banning of after-born illegitimates in *Jimenez*. While the evidentiary problem with respect to nonresident illegitimate claimants may be a greater one, as the Court acknowledged might be true regarding after-born illegitimates, it does not follow in the Court's words, "that the blanket and conclusive exclusion of [plaintiff's] subclass of illegitimates is reasonably related to the prevention of spurious claims." First, the statute's purpose of aiding familial survivors is not served by denying plaintiff's subclass any opportunity to demonstrate parentage. Second, the barring of nonresident illegitimates hardly promotes the goal of avoiding spurious claims, for the potential of false claims is the same as to both resident and nonresident illegitimates, just as it was the same as to both subclasses of illegitimates in *Jimenez*. As plaintiff's reply brief well points out:

> * * * defendant has not shown how [the live-with requirement would help to bar spurious claims], other than to assert that "it is highly unlikely that a claim on behalf of an alleged illegitimate child who is living with the alleged parent is spurious."

> * * * In this day and age because of the high rate of divorce and separation among the adult population it is highly likely for any woman's children to be living with an unrelated adult male. Suppose the male dies and the woman claims that the children are his. How does the "lived with" requirement help to bar such a spurious claim? * * *.

The live-with requirement causes the annuity statute to be underinclusive, presumptively denying benefits to nonresident illegitimates who may be dependent. In concluding that the requirement cannot withstand constitutional scrutiny, we can only echo the Court's final remarks in *Jimenez*. For all that appears from the papers before us, the two subclasses of illegitimates stand on equal footing, the potential for spurious claims does not differ from one to the other, and the different treatment of legitimates, which serves as a guide to the overall purpose of the statute, remains unexplained. On this basis, "to conclusively deny one subclass benefits presumptively available to the other denies the former the equal protection of the laws." 417 U.S. at 637. The live-with requirement denies plaintiff due process in violation of the Fifth Amendment.

The recent case of *Mathews* v. *Lucas*, 427 U.S. 495 (1976), is not contrary to this conclusion. *Lucas* dealt with a different provision of the same social security scheme considered in *Jimenez*. In *Lucas* it was claimed that the failure to include a nonresident, nonsupported illegitimate child among those "deemed dependent," and thus qualified for survivors' benefits, deprived appellees of equal protection. The statutory provision at issue, 42 U.S.C. § 402(d) (1970), presumes the financial dependency of legitimate children, acknowledged illegitimates, and those children illegitimate due to formal defects in the marriage of the deceased insured. Other illegitimate children were required to prove actual dependency upon the insured in order to be eligible for payments. The significant point, and indeed the one that distinguishes *Jimenez* and the present case from *Lucas*, is that the excluded illegitimates were nevertheless permitted under the statutory scheme to establish their residence with or dependency on the insured, and thus qualify for benefits. The Court specifically stated: "* * * this conclusiveness in denying

benefits to some classes of afterborn illegitimate children, which belied the asserted legislative reliance on dependency in *Jimenez*, is absent here, for, as we have noted, any otherwise eligible child may qualify for survivorship benefits by showing contribution to support, or cohabitation, at the time of death." 427 U.S. at 512. Thus, the statute comported with the announced purpose of aiding dependents. The Court found no constitutional defect in Congress' attempt to approximate those who might be dependent, where this did not entail cutting off from benefits those who actually were dependent, and did not base the demarcation line on the legitimacy of birth. In this case, however, as in *Jimenez*, the classification barring benefits to a subclass of illegitimates frustrates the dependency support scheme, and does so by employing birth status as the index to entitlement.

Defendant cites *Labine* v. *Vincent*, 401 U.S. 532, 539 (1971), in support of its argument that the live-with requirement is not unconstitutional. It says, paraphrasing the Court, that requirement did not create an insurmountable barrier to benefits.[5] Plaintiff, it argues, could have gained eligibility under the annuity statute simply by living with his alleged father prior to the latter's death. Thus, defendant attempts to make the requirement into something other than the conclusive bar condemned in *Jimenez*. Plaintiff, however, answers that the place of his residence, as a minor, was not within his choice. The law of his domicile, California, places his custody in his mother, where she is a fit parent. Cal. Civ. Code § 200 (West 1954); *Darwin* v. *Ganger*, 344 P. 2d 353 (Cal. App. 1959). From the record it appears that plaintiff's mother, his guardian in this action, had custody of him at all relevant times. Unless plaintiff's mother, Eunice Bradford, decided to take up residence with Leroy Gentry, or send plaintiff to live with him—under the same roof with Viney Gentry who is now Leroy Gentry's widow—plaintiff would not have any means of meeting the statute's live-with requirement, no matter how dependent he was on the deceased annuitant, and without regard to the alleged fact of

[5] *Labine* upheld Louisiana's discrimination against illegitimate children in the intestate succession of property, the Court noting that the statute in question did not absolutely bar inheritance by illegitimates. Their parents could by will designate them as heirs despite the statute.

parentage. Plaintiff was not in fact able to take up residence in his alleged father's home. We must not shut our eyes to the human realities of the present situation, as defendant would have us do in arguing that plaintiff had some choice about whether he would fall within the statute's excluded class. The truth is that he had no real opportunity to overcome the live-with requirement, and for this reason that requirement remains as much an insurmountable legislative barrier as the proscription of after-born illegitimates in *Jimenez*.

Before concluding this discussion, we must express some reservations about defendant's characterization of the purpose of the annuity statute's survivorship provisions. These do not, as in the case of the Social Security Act, explicitly specify dependency as a prerequisite to entitlement. Certain rules regarding the termination of benefits, when a child reaches majority and is not unable to work, and requiring that an illegitimate child live in a "regular parent-child relationship" with the employee or annuitant, suggest that aid to dependents is indeed the statute's primary concern. However, the absence of an express dependency requirement leads us to speculate that perhaps another congressional purpose is operating here. That purpose, we think, is the extension of benefits to surviving members of the immediate family of the annuitant, without regard to dependency. Viewed against this legislative intent, the live-with requirement still cannot stand under the due process clause. Analysis of the "spurious claims" rationale does not differ under this purpose, for the extending of benefits to those who actually are the annuitant's children is not served by an absolute ban on proof by nonresident illegitimates that they are his children. The potential for false claims of parentage is the same as to both the excluded and included subclasses of illegitimates, for reasons stated previously. However, if there is a congressional purpose to make payments available to those "most probably" the children of the annuitant, the analysis of the rationality of the nonresident illegitimate ban in light of that purpose must take a different tack. Where the legislative intent is to reach persons who are most likely the annuitant's children, as opposed to most likely dependent, it cannot be said that including all legitimate children in the class of

eligibles, whether residing with the annuitant or not, is on its face unreasonable. Congress obviously did not embrace the impermissible goal of depriving illegitimates across the board of what it gave to legitimates, for one subclass of illegitimates (those who satisfy the live-with requirement) can qualify for benefits. The question, then, becomes whether, consistent with due process, Congress may absolutely deny to one subclass of illegitimates the same benefits it presumptively makes available to another, for the apparent purpose of avoiding inconvenience to administrators.

The fashioning of classifications in aid of administrative convenience is not necessarily violative of constitutional guarantees. Such classifications, "though they may approximate, rather than precisely mirror, the results that case-by-case adjudication would show, are permissible under the Fifth Amendment, so long as that lack of precise equivalence does not exceed the bounds of substantiality [of relation to the statute's purpose] tolerated by the applicable level of scrutiny." *Mathews* v. *Lucas*, *supra*, 427 U.S. at 509. Though a legislative presumption in *Lucas* made it more difficult, *but not impossible*, for a subclass of illegitimates to enjoy benefits available to legitimates and another subclass of illegitimates on less stringent terms, the presumption was sustained against constitutional attack. The Court expressly stated that "to serve administrative convenience" was the purpose of Congress in writing the presumption into the statute. However, as noted before, the Court itself distinguished the legislative scheme it was upholding from one, as in *Jimenez* and the present case, where the classification employed did indeed make it impossible for an illegitimate child, otherwise eligible, to qualify for benefits. When the Court said in *Lucas*, 427 U.S. at 509, that the "applicable level of scrutiny" to a claim of discrimination against illegitimates "is not a toothless one," it cited *Reed* v. *Reed*, 404 U.S. 71 (1971), a sex discrimination case in which the Court held that a purpose of serving administrative convenience would not suffice to justify presumptively depriving one class of rights conclusively extended to another because of a legislative preference as to sex. We think the rule is that a legislative intent to serve administrative convenience by classification, though adequate

to support the classification in some circumstances, is impermissible when that classification amounts to an absolute barrier to the enjoyment, by one subclass of illegitimates, of benefits presumptively made available to another subclass. Such a classification exceeds the bounds of substantiality tolerable as to illegitimates. To hold otherwise would permit the very kind of discrimination against illegitimates *qua* illegitimates that equal protection concepts, as embodied in the due process clause of the Fifth Amendment, stand to prohibit.

Since there is no permissible legislative purpose which the live-with requirement of the annuity statute is known to promote in a rational manner, that requirement is void as against the due process clause of the Fifth Amendment. The statute must be construed, and payments made, without regard to the requirement. Defendant's motion for summary judgment must be denied.

## III. *Remand*

The annuity statute requires that the survivor (other than the spouse), in order to be entitled to benefits, be a "child" of the deceased employee or annuitant. Further, in the case of a natural child, as opposed to an adoptive child or one born in wedlock, the child must have been "recognized", by the decedent.[6] 5 U.S.C. § 8341(a)(3)(A)(ii) and § 8341(e) (1970). The CSC, under 5 U.S.C. § 8347 (b) and (c) (1970), is the sole and final arbiter of "all claims" such as factual questions of dependency, parentage, and recognition arising under the annuity statute.

It has never been determined that plaintiff is indeed the recognized, supported natural child of the deceased annuitant by whom he claims benefits. Defendant has not contested plaintiff's status as the recognized, supported natural child of the annuitant for purposes of its motion for summary judgment, while otherwise denying the annuitant's alleged paternity, support, and recognition of plaintiff. Defendant may properly do this, *Rains* v. *Cascade Indus., Inc.*, 402 F. 2d

[6] Whether the recognition requirement constitutes another form of discrimination against illegitimates is not raised by plaintiff as a constitutional issue.

241, 245 (3d Cir. 1968); 6 J. MOORE, FEDERAL PRACTICE ¶56.13, at 56–346 to 56–347 (1976), with the result that an issue of material fact exists barring us from granting plaintiff's cross-motion for summary judgment. Rule 101(d).

Defendant has not submitted any affidavits in opposition to plaintiff's mother's sworn statement that the deceased annuitant fathered, recognized, and contributed to the support of plaintiff. Within 4 weeks of Leroy Gentry's death, plaintiff's mother filed the present survivors' benefits claim on plaintiff's behalf with the CSC's Retirement Bureau. Further, it appears from the record that she received from the Social Security Administration, on plaintiff's behalf, dependents' benefits by virtue of Leroy Gentry's retirement, and that she claimed and received plaintiff's social security survivors' benefits by virtue of the alleged father's death in the month following his death. Normally, defendant's unsupported denials of plaintiff's factual allegations would not save it from a grant of summary judgment in plaintiff's favor. *Pacific Far East Line, Inc.* v. *United States*, 206 Ct. Cl. 378, 384–86, 513 F. 2d 1355, 1358–359 (1975); Rule 101(f). Here, however, as noted above, the statute commits basic factual determinations on which claims turn under the annuity statute to the CSC, and to it alone, unless of course fraudulent or arbitrary conduct at that level warrants judicial intervention. It would be improper to allow plaintiff to bypass this administrative procedure simply by the institution of suit. It is therefore necessary that the CSC be given the opportunity to decide whether plaintiff is in fact the child of the deceased annuitant, and whether the latter recognized and supported him as such. Accordingly, we must remand plaintiff's cause to the CSC with instructions to determine the answers to these questions and render to plaintiff any and all relief flowing therefrom. Rule 149.

Defendant's motion for summary judgment is denied, plaintiff's cross-motion for summary judgment is denied without prejudice to renewal, and the cause is remanded to the Civil Service Commission pursuant to Rule 149 and 28 U.S.C. § 1491 (Supp. V, 1975) with instructions to answer the unresolved questions stated in the opinion and grant all appropriate relief to plaintiff. Further proceedings are stayed

before this court for a period of six (6) months from the date hereof. Plaintiff's counsel is designated to advise the court by letter to the clerk of the status of the remand proceedings pursuant to Rule 149(f). See also Rule 150. If plaintiff establishes the aforesaid requisites to the CSC's satisfaction but it refuses to pay him administratively, he can return to court for his money judgment.

The petition in this case asks not only a money judgment for the annuity in issue but for a declaratory judgment of unconstitutionality of the live-with provision. Defendant has asserted a jurisdictional challenge to the latter in an affirmative defense. We have here held that the live-with requirement is unconstitutional in the context of ruling with finality on defendant's motion. Our authority to issue a declaratory judgment is limited. *United States* v. *King*, *supra*. We are authorized to do so only where "it is tied and subordinate to a monetary award." *Austin* v. *United States*, 206 Ct. Cl. 719, 723, *cert*, *denied*, 423 U.S. 911 (1975). And of course we can do so where it is explicitly authorized, as in certain tax cases under section 1306 of the Tax Reform Act of 1976, approved Oct. 4, 1976, to appear as 28 U.S.C. § 1507. That portion of plaintiff's petition asking for a declaratory judgment is dismissed.

---

NICHOLS, *Judge*, concurring:

I join in the decision and in Judge Bennett's opinion. Much as I would like to avoid deciding on constitutional grounds, I cannot read the statute as allowing the illegitimate child to qualify for survivor benefits if he did not live with the civil service annuitant. And this is the administrative construction, which is always entitled to respect. The Supreme Court in *Jimenez* v. *Weinberger*, 417 U.S. 628 (1974), did not reconstruct the statute then before it in such a fashion, but took it as it read.

The heart of the matter is this: our society normally imposes different responsibilities on the parents of an illegitimate child, if they do not live together. The mother provides the home and rears the child. The father, if he admits his paternity or it is established by judicial proceedings, must furnish financial support. I have never heard of a bastardy

complaint against a mother. Now, if both parents enact these roles, the mother can pass on survivorship benefits to the child, if a former civil servant, but the father cannot. This is a crude form of sexual discrimination against the male, like many statutory provisions of other kinds. My analysis is supported by *Frontiero* v. *Richardson*, 411 U.S. 677 (1973); and *Reed* v. *Reed*, 404 U.S. 71 (1971). The child is a victim of the discrimination and has standing to complain. In *Mathews* v. *Lucas*, 427 U.S. 495 (1976), the illegitimate child could have qualified for survivorship benefits by either having lived with or having received support from the father, and thus the Social Security legislation there involved did not discriminate against him in the same manner.

---

SKELTON, *Judge*, concurring in the result:

I do not think it is necessary to hold that 5 U.S.C. § 8341(a)(3)(A)(ii) (1970) is unconstitutional in order to obtain the result reached by the majority in this case. That section of the statute provides as follows:

> § 8341. Survivor annuities.
> (a) For the purpose of this section—
> (3) "child" means—
> (A) * * * (ii) a stepchild or recognized natural child who lived with the employee or Member in a regular parent-child relationship;

It is logical to assume that by enacting this part of the statute relating to a stepchild and an illegitimate child, the Congress was establishing a test or method by which two facts could be proven or determined, namely, (1) that the deceased employee was actually the parent or step-parent of the child, thereby eliminating spurious claims of a child not related to the employee, and (2) that the child was dependent upon the employee for support. The Congress obviously concluded that if a stepchild or illegitimate child was living with an employee, a presumption was created that the two above-mentioned conditions or requirements have been established, although the statute does not say so. Therefore, it is a question of how the live-with portion of the statute should be read and interpreted. It would be a rare case indeed and an almost unheard of situation if a child lives with an employee

when the child is not related in any way to the employee and the employee is not supporting the child. A natural conclusion is that the live-with portion of the statute was inserted as a means of proving paternity and dependency.

Congress did not apply the live-with requirement to a legitimate child of an employee, as it can be assumed and presumed that an employee will support his natural child whether the child lives with the employee or not.

The statute should not be read nor interpreted as an absolute bar to annuity benefits for a stepchild or illegitimate child of an employee who cannot meet the live-with test, but should be read and interpreted so as to allow such a child to prove paternity and dependency in some other way. The majority is allowing such proof to be made in the instant case, but only after holding the live-with portion of the statute unconstitutional.

It is not necessary to hold any part of the statute unconstitutional in order to allow the plaintiff in this case to prove paternity and dependency at a trial in the manner correctly ordered by the majority. The statute should be read and interpreted so as to allow such proof if the live-with proof cannot be supplied.

There is a well-established rule that, if possible, a statute should be interpreted in such a way that it will be constitutional and valid rather than unconstitutional and invalid. This rule was aptly stated by the Supreme Court in *National Labor Relations Board* v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937) as follows:

> * * * The cardinal principle of statutory construction is to save and not to destroy. We have repeatedly held that as between two possible interpretations of a statute, by one of which it would be unconstitutional and by the other valid, our plain duty is to adopt that which will save the act. * * * [*Id.* at 30.]

*See also*, *Federal Trade Comm'n* v. *American Tobacco Co.*, 264 U.S. 298, 307 (1924); *Panama R.R. Co.* v. *Johnson*, 264 U.S. 375, 390 (1924); *Missouri Pacific R.R. Co.* v. *Boone*, 270 U.S. 466, 472 (1926); *Blodgett* v. *Holden*, 275 U.S. 142, 148 (1927); *Richmond Screw Anchor Co.* v. *United States*, 275 U.S. 331, 346 (1928); and 16 C.J.S. *Constitutional Law* § 98 at 357–58 (1956).

I would follow this rule and reach the same result as that reached by the majority without holding the live-with portion of the statute unconstitutional. For that reason, I concur with the result stated in the majority opinion.

---

551 F. 2d 852

ON DEFENDANT'S MOTION FOR REHEARING EN BANC PURSUANT TO RULES 7(d) AND 151

[April 1, 1977]

ORDER

*Richard A. Weinstock*, attorney of record, for plaintiff.

*Donnie Hoover*, with whom was *Assistant Attorney General Barbara A. Babcock*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and BENNETT, *Judges*.

---

This case come before the court on defendant's motion, filed January 18, 1977, for rehearing *en banc* pursuant to Rules 7(d) and 151. Upon consideration thereof, together with plaintiff's response in opposition thereto, without oral argument, by the seven active judges of the court (Chief Judge Cowen then sitting) as to the suggestion for rehearing *en banc* under Rule 7(d), the suggestion is denied. The case has further been considered by the panel listed above as to the motion for rehearing under Rule 151.

Defendant has raised two points in its brief accompanying its motion for rehearing which we find it appropriate to answer. First, defendant argues that the Supreme Court's decision in *Mathews* v. *de Castro*, 429 U.S. 181 (1976), announced one month after this court's opinion in the present case, is contrary to our previous opinion. In *de Castro* the Court sustained against constitutional challenge a provision of the Social Security Act which extends "wife's insurance benefits" to a married woman under age 62 who has a minor or dependent child in her care and whose husband retires or becomes disabled, but denies such benefits to a divorced woman

under 62 having such a child in her care whose former husband retires or becomes disabled. The Court reasoned:

> * * * Congress could have rationally assumed that divorced husbands and wives depend less on each other for financial and other support than do couples who stay married. * * * [D]ivorced couples typically live separate lives. It was not irrational for Congress to recognize this basic fact * * *. [429 U.S. at 189]

Defendant says that if Congress could constitutionally presume divorced wives less dependent on their former spouses than married wives on their present spouses, thus conferring benefits on the latter group while withholding them from the former, then Congress could also validly presume that illegitimate children who do not live with their annuitant fathers are less dependent on them than are those children who live with them, with the same results for the distribution of benefits. Thus, according to defendant, *de Castro* controls the present case, and defeats a recovery for plaintiff.

We think that defendant's analogy to *de Castro* is inapt. *de Castro* involved a distinction based on marital status, rather than birth status. *Jimenez* v. *Weinberger*, 417 U.S. 628 (1974), which like the case at bar dealt with statutory distinctions implicating birth status, is much closer factually to this case. *de Castro*, which did not even mention *Jimenez*, is not rightly viewed as overruling the latter. *Mathews* v. *Lucas*, 427 U.S. 495 (1976), decided just 6 months before *de Castro*, implicitly reaffirmed the validity of *Jimenez* when it distinguished its situation, where an illegitimate child was accorded the opportunity to establish dependency, from that which proved critical and fatal to the statute in *Jimenez*, where one subclass of illegitimates was forbidden to establish the dependency conclusively presumed to exist in others. We said in our previous opinion that, for all that appeared on the record before us, the child excluded from participation in survivor's benefits (such as plaintiff) was in the same situation as the included child. Our statement (*ante* at 18) was practically a quote from *Jimenez*, *supra*, 417 U.S. at 637: "* * * for all that is shown in this record, the two subclasses of illegitimates stand on equal footing * * *; hence to conclusively deny one subclass benefits presumptively available to the other denies the former the equal protection of the

laws * * *." There is no reason to believe that this is not still the law.

The Court in *de Castro* obviously did not view the class of divorced women as standing on the same footing with married women. However, as in *Jimenez*, defendant has shown us nothing to justify a conclusion that the members of the two subclasses in the present case, distinguished by statutory criteria implicating birth status, stand on different footing. While Congress and the Court might find from common experience that divorced wives are usually less dependent on former husbands than married wives are on their spouses, the application of such experience and reasoning to nonresident illegitimate children is by no means apparent. As plaintiff notes in its brief opposing rehearing, alimony for the divorced wife is frequently a matter for equitable relief, not always awarded, sustaining the view that divorced wives' dependence on the former husband is not the unwavering rule, but that probably the contrary is true. Child support, on the other hand, including support for the illegitimate child, is almost universally a legal requirement, attesting to the questionable validity of any assumption that some subset of illegitimates, those not residing with the annuitant, is invariably beyond the realm of financial support. The rationality of the legislative presumption of financial independence in *de Castro* is supported by the reasoning that the typical divorced wife can (not necessarily does) earn her own living, though this can hardly be carried over to the case of the illegitimate minor. We are not prepared to abandon our previous reliance on the Court's reasoning in cases involving discriminations against illegitimates in order to embrace defendant's invitation to rest our ruling on a factually inapt case involving quite a different variety of statutory distinction. We remain mindful of the Court's teaching in *Weber* v. *Aetna Casualty & Surety Co.*, 406 U.S. 164, 175 (1972), that legislative distinctions implicating the illegitimate status of birth are subject to constitutional review in light of the admonition that "visiting this [society's] condemnation [of irresponsible liaisons beyond the bonds of marriage] on the head of an infant is illogical and unjust."

An independent reason why *de Castro* does not control the result in this case is that, as we said in the earlier opinion, the purpose of the Civil Service Retirement Act, as amended, is not clearly limited to the granting of aid to financial dependents, but may well include "the extension of benefits to surviving members of the immediate family of the annuitant, without regard to dependency." (*Ante* at 20.) *de Castro* admittedly confined its reasoning to the environment of the old age, survivor's, and disability insurance aspects of the Social Security law, which is heavily grounded in the objective of replacing earnings lost through retirement, illness, or death. Under the Civil Service annuity scheme, however, neither dependency nor partial support, presumed or proved, expressly plays a role in the distribution of benefits to survivors. Confirming our previous "speculation" that financial dependence is not the touchstone of the flow of benefits is the fact, unknown to us when the opinion was announced but recently brought to our attention, that a dependency requirement for illegitimates placed in the statute by the 1956 amendments was deleted by new legislation in 1966. Prior to 1966 the statute's definition of child included a "recognized natural child who received more than one-half of his support from and lived with" the annuitant. 5 U.S.C. § 2251(j)(2) (1964). The Act of July 18, 1966, Pub. L. 89–504, § 502, 80 Stat. 300, deleted the words "received more than one-half his support from and," with the stated purpose of eliminating "the requirement that a child be dependent upon a Federal-employee parent in order to receive a survivor annuity," in order to extend benefits to the children of a working mother. S. REP. NO. 1187, 89th Cong., 2d Sess. (May 26, 1966), 2 U.S. CODE CONG. & AD. NEWS 2495, 2498 (1966). To the extent that this legislative action and history undermine the parties' original explanation of the annuity law as intending to aid the financial beneficiaries of the annuitant, and to the extent that they support our earlier alternate view of the statute's purpose, *de Castro* is simply inapposite to the disposition of this case.

Defendant's second point in its brief which we think it proper to address, particularly for the benefit of the Civil Service Commission on remand and of any future panel of

this court which may encounter this problem on a subsequent appeal, is the contention that absent the live-with requirement, the statute cannot be rationally administered. Defendant argues that, without the live-with requirement as a guide to determining dependency, there remains no criterion in the statute by which to measure the degree of the beneficiary's financial dependence—more than one-half his support, a substantial portion of his support, or merely some part of his support provided by the annuitant—necessary to qualify him for the receipt of benefits. This argument, of course, assumes again that the annuity law's purpose is the aiding of financial dependents. Defendant contrasts this absence of criteria with the situation in *Jimenez*, where remaining provisions of the Social Security Act stated the extent of the previous support from the insured needed to qualify the beneficiary. While we acknowledge that our opinion has left this matter unresolved, speaking at times of "dependence" and at other times of "contribution to support," and also holding open the possibility that the degree of financial dependence is irrelevant to a recovery, we think that this is a problem of the parties' own making, and partly on that account one not yet ripe for resolution.

Both plaintiff and defendant argued this case to us with the assumption that aid to dependents was the prime objective of the Civil Service Retirement Act, as amended. The original argument on neither side focused on the problem defendant now raises. Since the proper construction of the statute with respect to the degree of financial dependence required in the beneficiary was not briefed to us, and since the result of the proceedings before the Civil Service Commission, or the possibility dependence will ultimately be held irrelevant to the distribution of benefits, may obviate the need to resolve the point in question, we see no reason to modify our previous opinion at this time. Plaintiff expressed the intention of proving to a fact-finder that the annuitant supported him to some extent. If plaintiff's proof on the matter of support satisfies the Commission, there may be no call in this case to resolve the role of dependency under the annuity statute. If plaintiff and the Commission are unable to agree on the sufficiency of plaintiff's proof, or on the legal showing required to

obtain benefits, the parties will have the opportunity of returning here and arguing what role, if any, the degree of dependence has to play in the distribution of survivor's benefits under the statute. Accordingly, while defendant's contention is an important one, raising a significant question for the administration of the statute, we have no need as yet to rule on it.

IT IS THEREFORE ORDERED that defendant's motion for rehearing be, and the same is hereby, denied.

---

545 F. 2d 727

## MAE BOURGEOIS v. THE UNITED STATES

[No. 168–75. Decided November 17, 1976. Defendant's motion for rehearing or suggestion for rehearing *en banc* denied April 1, 1977.]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Property; federal grant of shoreland property; title to island in nonnavigable water; federal v. state law.**—Plaintiff seeks to recover the value of an island allegedly appropriated by the Government in 1971 and located in a land-locked, non-navigable lake in Michigan. Plaintiff contends that title to the island passed to a predecessor in title to whom two of the shoreline lots were patented in 1866. Also, in 1866 the Government passed title to all other lands adjoining the lake. The patents do not mention conveyance or reservation of the island. It is *held* that under federal common law if the intent of the Government is ambiguous when it grants shoreland along non-navigable waters, title to unmentioned islands passes according to the law of the state in which the property is located. Accordingly, since the intent of the Government is ambiguous, Michigan law controls and title to the island transferred in 1866. If plaintiff can adequately establish that she succeeded to the predecessor's ownership interests, she will be able to recover for defendant's 1971 taking of that portion of the island belonging to her. The court remands this case to the trial division with direction for further proceedings consistent with the opinion. Plaintiff's motion for summary judgment is granted and defendant's cross-motion is denied.

---

*Judge Kashiwa would allow defendant's suggestion for rehearing *en banc* under Rule 7(d) and motion for rehearing under Rule 151. Footnote 4 appearing in the slip opinion has been vacated and rewritten as it appears in this report.

**Court of Claims jurisdiction; eminent domain; just compensation; quiet title issue present.**

[1] Since this court under 28 U.S.C. § 1491 has jurisdiction over Fifth Amendment taking cases, it is not denied jurisdiction simply because there is a quiet title issue involved in determining entitlement to just compensation *val non.*

Courts ⟸ 449(1)

**Property; patents or public grants; interpretation; applicable law.**

[2] In interpreting the intent of the Government when reviewing a federal grant, federal, not state law, controls, and where the statutes are silent as to the construction of federal patents, such interpretation involves an analysis of federal common law.

Public Lands ⟸ 114(1)

**Property; shoreland property; federal grant, rights under; island in non-navigable waters; applicable law.**

[3] Under federal common law, if the intent of the Government was ambiguous in making grants to all shoreland property surrounding a land-locked non-navigable body of water, and absent any expression in the grants regarding conveyance or reservation of an island in the law of the state in which the property is located.

said body of water, the grants passed title to the island according to

Commerce ⟸ 82.25

**Eminent domain; taking; what constitutes.**

[4] A fifth amendment taking of that portion of the subject island belonging to plaintiff is evidenced by government posting of the property as government land and the letter from the Department of Agriculture to plaintiff's attorney pronouncing the island to be federal land.

Eminent Domain ⟸ 63

*Seymour Kraus*, attorney of record, for plaintiff.

*Michael K. Murray*, with whom was *Assistant Attorney, General Peter R. Taft*, for defendant.

---

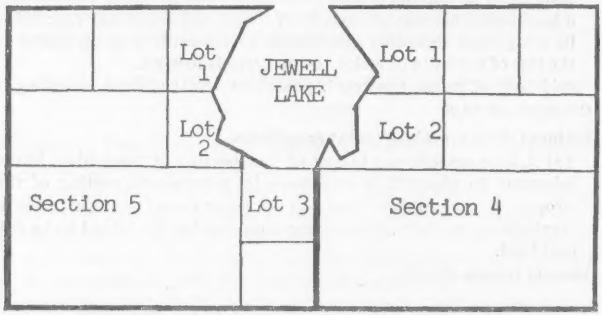
Before NICHOLS, KASHIWA, and KUNZIG, *Judges.*

KUNZIG, *Judge*, delivered the opinion of the court.

Plaintiff in this Fifth Amendment taking case of first impression attempts to recover the value of an island allegedly appropriated by the Government in 1971 in a land-locked, non-navigable lake. In her motion for summary judgment, plaintiff asks the court to find that, as a matter of law, she held title to the island until its appropriation by the Government. By cross-motion, defendant would have us deter-

mine that plaintiff did not hold title to the island and cannot recover for an alleged taking. To the extent outlined below, we hold for plaintiff.

The history of the present dispute can be traced to 1846. In that year, Michigan Township No. 26 N was first surveyed. The surveyor meandered a lake now known as Jewell Lake. Unfortunately, the disputed island was omitted from the survey and the 1846 Plat. The 1846 survey divided the land adjoining the lake into five lots in two sections. Lot No. 1 of Section 4 contained 47.12 acres; Lot No. 2 of Section 4, 53.30 acres; Lot No. 1 of Section 5, 43.89 acres; Lot No. 2 of Section 5, 30.0 acres, and Lot No. 3 of Section 5, 43.0 acres. This survey can perhaps be better explained by the following graphic illustration:

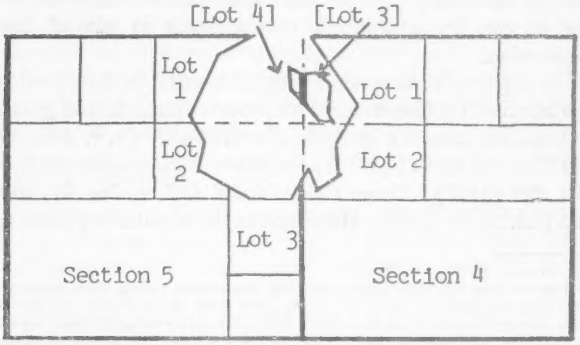



On January 15, 1866, defendant, pursuant to the Bounty Land Act of 1855 granting land to war veterans, patented Lots No. 1 and 2 of Section 4 to Wm. E. Dodge as assignee of Elizabeth Phillips, the widow of a War of 1812 veteran. The patent was for 100.42 [47.12+53.30] acres of land. However, as the island was omitted from the survey and the Plat, it was also omitted from the patent. At about the same time, defendant also patented the remainder of the shoreland without reserving title to the island.

In 1939, plaintiff and her now deceased husband purchased Lot No. 1 of Section 4, originally patented to Dodge in 1866. Plaintiff claims and defendant does not contest, that upon her husband's death, she acceded to entire ownership of this interest. Although the record is somewhat unclear as to the

grantor, it appears that in 1939 defendant reacquired Lot No. 2 in Section 4, either from plaintiff or from plaintiff's grantor. Defendant states that it received the lot from "Milton L. Whiteman."

In 1958 the island was surveyed for the first time and the official Plat was accepted on August 4, 1959. The island appears on this Plat as Lot No. 3 of Section 4 (5.54 acres) and Lot No. 4 of Section 5 (1.22 acres). The following illustration shows the redrawn Plat:




In 1971 the Government "posted" the island as Government land, and plaintiff began her attempt to vindicate her asserted rights to the island.

Plaintiff now moves for summary judgment, arguing that title to the island passed at the time of the 1866 patents and that defendant, by its action in 1971, has taken her land without just compensation. Defendant counters in its cross-motion that it never parted with title to the island, has owned it continuously since 1846 and before and, accordingly, has not taken any land belonging to plaintiff.[1]

[1] In its answer, the Government raises defenses which are not before the court on these cross-motions for summary judgment. However, one assertion by defendant—that this suit is really one to quiet title and therefore within the exclusive jurisdiction of the district courts under 28 U.S.C. 2409a and 1346(f)—must be addressed, as it strikes at the power of this court to hear the action.

28 U.S.C. 2409a (enacted in 1972) states that it does not affect actions which could be brought under 28 U.S.C. 1346 or 28 U.S.C. 1491. *Cf. Manning v. United States*, 200 Ct. Cl. 739 (1972). Under 28 U.S.C. 1491, the Court of

(Continued)

We hold that defendant transferred title to the island when it patented the lands on shore in 1866. Accordingly, we hold that insofar as plaintiff can prove her ownership of Lot No. 1 in Section 4, she is entitled to recover.[2]

Unquestionably, in 1866 defendant passed title to all lands adjoining Jewell Lake, a land-locked non-navigable body of water. Because the patents to such grants are silent as to the island currently in dispute, and the clear intent of the grantor is at best ambiguous, the court must fathom the intent of the grantor at the time the shoreland was ceded. As far as can be determined, this question is one of first impression.

We start with the general proposition that in interpreting the intent of the Government when reviewing a federal grant, federal, not state law controls. *Bonelli Cattle Co.* v. *Arizona*, 414 U.S. 313, 320–21 (1973); *Hughes* v. *Washington*, 389 U.S. 290, 292 (1967); *Borax Consolidated Ltd.* v. *Los Angeles*, 296 U.S. 10, 22 (1922). Moreover, as the statutes are silent as

(Continued)
Claims has long had jurisdiction over Fifth Amendment taking cases. *Causby* v *United States*, 328 U.S. 256, 267 (1946). This court is not denied jurisdiction now, simply because there is a quiet title issue involved in determining entitlement to just compensation *vel non*. As the Supreme Court stated in *Malone* v. *Bowdoin*, the Court of Claims is an appropriate forum where plaintiff can try title by seeking just compensation for the taking of land by the United States. 369 U.S. 643, 647 n. 8 (1962). (Note that *Malone* preceded the enactment of 28 U.S.C. 2409a by ten years.) *Carlson & Carlson* v. *United States*, 208 Ct. Cl. 1022, 1023 (1976), establishes the vitality of *Malone* in a post-1972 setting.

If plaintiff had brought suit to be restored possession of her land, perhaps the issue would be different and 28 U.S.C. 2409a might require this suit be brought in the district court. But this is not a suit for possession. It is a *just compensation action* and thereby within the historical jurisdiction of the court. To hold otherwise would allow defendant in its answer to determine the situs of an action by alleging governmental ownership. This we decline to do.

Judge Kashiwa, in dissent, makes much of the fact that plaintiff was allegedly "agreeable" to transfer the cause to a district court. We question that plaintiff would "rather" be in district court. When the dissenting judge asked at oral argument whether plaintiff's counsel would favor a return of the case to the district court *were the Court of Claims to determine it had no jurisdiction*, counsel indicated "[u]nder those conditions, your Honor, we would be satisfied to transfer the case to the district court."

In any event, in open court at oral argument, counsel for the government clearly conceded "as between the parties, this court has jurisdiction to decide title, the issue which is now present. I believe that this court can decide title."

[2] We do not decide herein that plaintiff has proven her ownership of Lot No. 1, nor do we make any finding as to the value of the island, nor any conclusion as to the method of dividing ownership of the island among the various owners of shoreline property.

to the construction of federal patents, such interpretation, of necessity, involves an analysis of federal common law.

A survey of federal cases reveals that there are two distinct lines of demarcation in evaluating title to islands when the shoreland is patented: navigable water cases, and non-navigable water cases. Based on the briefs filed in the instant case, and the oral argument, it appears to be uncontroverted that Jewell Lake is non-navigable.

In the navigable water cases, ownership in the navigable stream *beds* passed to the state at the time of admission of a state into the Union both under federal statute and as a concomitant of state sovereignty. *Bonelli Cattle Co.*, *supra.* However, where the Federal Government patents shoreland along navigable waters without denoting an intent to pass title to off-shore *islands*, it has been held that title to the islands remains with the Federal Government. *Scott* v. *Lattig*, 227 U.S. 229 (1913).

In the non-navigable waters area, the situation becomes quite different. Insofar as the title to non-navigable water *beds* is concerned, federal law looks to the law of the state in which the land lies or common law, if no clear intent is expressed in the patent. *Oklahoma* v. *Texas*, 258 U.S. 574, 594–95 (1922); *Hardin* v. *Jordan*, 140 U.S. 371, 384 (1891); *Mitchell* v. *Smale*, 140 U.S. 406 (1891).

Were there no federal interest whatsoever in this matter, the solution would be clear. Both parties admit that *Michigan* law is to the effect that a conveyance of shoreland on a non-navigable body of water will pass title to unsurveyed islands in the body of water to the grantee of the shoreline property. *Ottawa Shores Home Owners' Assn.* v. *Lechlak*, 344 Mich. 366, 73 N.W. 2d 840 (1955); *Grand Rapids Ice & Coal Co.* v. *South Grand Rapids Ice & Coal Co.*, 102 Mich. 227, 236, 60 N.W. 681, 684 (1894); *Webber* v. *Pere Marquette Boom Co.*, 62 Mich. 626, 30 N.W. 469 (1886); *Fletcher* v. *Thunder Bay River Boom Co.*, 51 Mich. 277, 16 N.W. 645 (1883). *Cf. Grand Rapids & IR Co.* v. *Butler*, 85 Mich. 246, 48 N.W. 569, *aff'd*, 159 U.S. 87 (1895).

But we have said above that when reviewing a *federal* grant *federal* law applies, and determining intent involves an analysis of *federal common law.*

It is clear that given no indicia of patentor intent, if this were a *navigable water "bed case,"* the bed would belong to the state. If it were a navigable water "island case," the island would belong to the Federal Government. If it were a non-navigable water "bed case," the bed would belong to the shore owners in "pie-shaped" fashion to the center of the body of water under federal common law which looks to the law of the state (in this case, Michigan). *Grand Rapids Ice & Coal Co., supra.* However, this is where the clarity ends, for the parties have not cited, nor can we discover, any non-navigable water "island cases," where intent of the Federal Government in patenting shoreland is not expressed.

Obviously, plaintiff attempts to rely on the non-navigable water "bed cases" under which doctrine she would have obtained title to at least part of the island in question under federal law and the law of Michigan via the 1866 federal grants to Wm. E. Dodge. On the other hand, defendant urges application of the navigable water "island cases" under which it has been held that the Government retains title to islands despite the patent of shorelands. Given the fact that there are no non-navigable "island cases," we must determine which analogy is better suited to the instant situation.

As an initial matter, we take note that the intent of the Government (to grant or retain the islands in its 1866 patent) cannot be fathomed. The grant fails either to convey or to reserve the island. The grant itself specifies the acreage of the patent based upon the shoreland only, but this is more likely than not due to the fact that the island was inadvertently omitted from the 1846 Plat. From the size of the island (6.76 acres), its relative remoteness and rather small value in 1866, it can, at best, be inferred that in 1866, neither the Government nor the patentee cared much about who held title to the island. Finally, if anything, the fact that the Government patented all the other land around the lake in 1866 denotes the probability that if it had been aware of the island's existence, it would have patented the island also.[3] In total, the factors bearing on intent produce no definitive re-

[3] If the Government had not intended to patent the island, then it probably would have reserved an approach to the lake. This it did not do.

sult. Accordingly, we must fashion a rule to construe title to islands in non-navigable water cases.

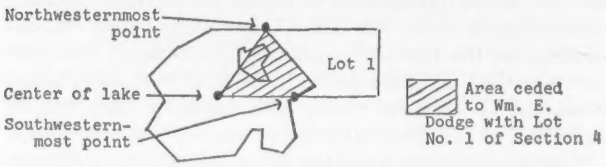
Given the choice between the navigable water island cases and the non-navigable water bed cases, *the best analogy is the non-navigable water bed law.* To reach this result we concentrate on the fact of accessibility, particularly with reference to the time of the grant. In the navigable water island cases, the Government could, with impunity, cede title to shoreland while retaining access by the navigable water route.

The non-navigable water bed situation presents a quite different picture. Here, where the land bordering a non-navigable body of water is ceded, the beds pass (unless the intent of the grantor is expressly stated to the contrary) according to state law. Under Michigan law, title to the beds passes to the shoreland owners. It would make little sense for the Government to pass title to all shorelands without reserving access easement to islands and expect to be able to use either the water or the beds, particularly in 1866 before the advent of air travel.

Thus it is equally obvious in the non-navigable water situation that a grant which passes shoreland and beds to a patentee should also pass title to midstream islands absent a clear expression of contrary intention by the grantor. In the instant case, having ceded all of the shoreland around Jewell Lake, and having failed to reserve an easement, there would have been absolutely no way for defendant to use the island in question.

Accordingly, under federal common law, we hold that if the intent of the grantor is ambiguous and the Government grants shoreland along non-navigable waters, it also passes title to islands according to the law of the state in which the property is located. Therefore, in the instant case, under Michigan law the 1866 patent of Lot No. 1 of Section 4 to Wm. E. Dodge also passed title to at least a portion of the island whose title is currently in issue. Such grant gave Dodge title to underwater beds and the island as measured in "pie-shaped" fashion. *Grand Rapids Ice & Coal Co., supra.* Thus, the grant included beds and island land lying in the angle formed by drawing a line from the center of Jewell Lake to the northwesternmost point of Lot No. 1 on the shore-

line, and another line from the center of the lake to the southwesternmost point of Lot No. 1 on the lakeshore, according to the following illustrated approximation:




If plaintiff can adequately establish that she has succeeded to Dodge's ownership interests in Lot No. 1, she will be able to recover for defendant's 1971 taking [4] of that portion of the island belonging to her.

On remand, the following items, among others, remain to be resolved: (1) Plaintiff's title to Lot No. 1, Section 4, Township No. 26 N, Range TE, Michigan Meridian, Michigan; (2) the center point of Lake Jewell; (3) the island acreage owned by plaintiff, if any, taken by defendant in 1971, and (4) the value of the island (and plaintiff's portion of the island) appropriated by defendant without just compensation.

Accordingly, plaintiff's motion for summary judgment is granted, defendant's cross-motion for summary judgment is denied, and the case is remanded to the Trial Division for further proceedings consistent with this opinion.

---

KASHIWA, *Judge*, dissenting:

The majority opinion briefly discusses in its footnote 1 the question of jurisdiction of this court over plaintiff's cause of action. I do not agree with the majority's conclusion for reasons hereafter stated.

As its third defense, defendant specifically alleges in its answer to the amended petition as follows:

---

[4] Evidenced by government posting of the property as government land, and the letter from the Department of Agriculture to plaintiff's attorney pronouncing the island to be federal land. In addition to these acts (conceded by the Government), plaintiff alleges that the Government ordered her off the property, excluded her son, and refused to allow her to install electricity on the land.

Dissenting Opinion by Judge Kashiwa

This Court is without jurisdiction of this cause because this is in fact an action to adjudicate a disputed title to real property in which the United States claims an interest and as such is within the exclusive original jurisdiction of the District Courts pursuant to 28 U.S.C. sections 2409a and 1346(f).[1]

The sections of statutes referred to in the margin were enacted by Pub. L. 92-562, 86 Stat. 1176 (October 25, 1972), entitled "An Act to permit suits to adjudicate certain real property quiet title actions."

Plaintiff's initial civil action in the Circuit Court for the County of Alcona, State of Michigan, which prayed that the defendant, a District Ranger in the United States Forest Service, be enjoined from exercising any ownership interest in the island in question, was removed to the United States District Court, Eastern District of Michigan. The District Court should have considered the action "essentially a quiet title action." *County of Bonner* v. *Anderson*, 439 F. 2d 764 (9th Cir. 1971). Upon plaintiff's motion for rehearing which was denied on September 23, 1974, the District Court should have retained jurisdiction, reversing its earlier dismissal which was on grounds of sovereign immunity. As aforementioned, Pub. L. 92-562 was enacted October 25, 1972.

Although plaintiff filed her petition in this court on May 16, 1975, plaintiff would rather be in District Court. At the time of oral argument before this court, plaintiff's attorney responded in the affirmative to my question as to whether he would like to have this case transferred to the United States District Court for the Eastern District of Michigan, Northern Division.

In dismissing defendant's jurisdictional defense, the majority points to, and I am aware of, our order entered in *Carlson & Carlson* v. *United States*, 208 Ct. Cl. 1022 (1976). That order, however, is not contrary to my views herein. *Carlson* dealt with an absolute exclusion under 28 U.S.C.

[1] 28 U.S.C. § 1346(f) reads as follows:

"(f) The district courts shall have exclusive original jurisdiction of civil actions under section 2409a to quiet title to an estate or interest in real property in which an interest is claimed by the United States."

28 U.S.C. § 2409a reads as follows:

"(a) The United States may be named as a party defendant in a civil action under this section to adjudicate a disputed title to real property in which the United States claims an interest, other than a security interest or water rights.

§ 2409a to restricted Indian lands in which title is held by the United States. See *Carlson* v. *Tulalip Tribes of Washington*, 510 F. 2d 1337, 1339 (9th Cir. 1975). Section 2409a specifically provides:

> * * * This section does not apply to trust or restricted Indian lands, nor does it apply to or affect actions which may be or could have been brought under sections * * * 1491 * * * of this title * * *.[2]

As demonstrated by plaintiff's initial petition filed in District Court, and as raised by defendant's jurisdictional defense, this case is not correctly a claim against the United States founded upon the Fifth Amendment. Rather, in effect, this is a quiet title action which should have been instituted against the United States pursuant to § 2409a. The allegation made by the plaintiff of interference with possession, caused by the defendant merely posting a sign and excluding on one instance plaintiff's son from the island, is not sufficient to support an involuntary taking. The sign placed on the island is no more significant a taking than the letter of November 9, 1971, to plaintiff from the United States Department of Agriculture that defendant considered the island to be "Federal land administered by the United States Government." Such a procedure does not amount to a direct and actual intrusion. At most, the majority can point to only a nebulous or proposed taking by defendant of plaintiff's property. The character of this invasion does not constitute a taking of the property in issue. See *Pitman & Pitman* v. *United States*, 211 Ct. Cl. 357 (1976); *Hilkovsky* v. *United States*, 205 Ct. Cl. 460, 464, 504 F. 2d 1112, 1113 (1974); *Woodland Market Realty Co.* v. *Cleveland*, 426 F. 2d 955, 958 (6th Cir. 1970). Therefore, § 1491 is inapplicable and § 1346(f) is controlling, giving exclusive original jurisdiction to the District Court in

---

This section does not apply to trust or restricted Indian lands, nor does it apply to or affect actions which may be or could have been brought under sections 1346, 1347, 1491, or 2410 of this title, sections 7424, 7425, or 7426 of the Internal Revenue Code of 1954, as amended (26 U.S.C. 7424, 7425, and 7426), or section 208 of the Act of July 10, 1952 (43 U.S.C. 666)."

[2] 28 U.S.C. § 1491 as pertinent herein reads as follows:

"The Court of Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department, or upon any express or implied contract with the United States, * * *."

order to quiet title to interests in the island real property in which an interest is claimed by the United States.

The majority seems to rely solely on the form of the present petition and the above-quoted sentence of § 2409a to solve the jurisdictional question raised by defendant. The problem is far from being that simple. A careful examination of the purpose of the legislation together with the other provisions of Pub. L. 92–562 must be made.

The purpose of Pub. L. 92–562 as stated in the Legislative History of the Act, 3 U.S. Code Cong. and Adm. News 4547 (1972), is to remedy the troublesome situation caused by decisions applying the defense of sovereign immunity. *Malone* v. *Bowdoin*, 369 U.S. 643 (1962); *Larson* v. *Domestic & Foreign Corp.*, 337 U.S. 682 (1949). But see *Land* v. *Dollar*, 330 U.S. 731 (1947); *United States* v. *Lee*, 106 U.S. 196 (1882). Although the plaintiff in *Malone* was denied relief under the defense of sovereign immunity, the majority of the Court in *Malone* stated at page 647, footnote 8:

> * * * Unlike the situation in the *Lee case* [106 U.S. 196], there has been at all relevant times a tribunal where the respondents could seek just compensation for the taking of their land by the United States. That tribunal is the Court of Claims. *United States* v. *Causby*, 328 U.S. 256, 267.

The majority herein relies on the Court's footnote reference to the remedy in the Court of Claims. But it is well to note that *Malone* preceded Pub. L. 92–562 by 10 years. The Department of Justice realized the unjustness of the sovereign immunity rule and sponsored Pub. L. 92–562.[3] The unjustness as it is applicable to plaintiff in the present suit is well expressed by the dissenting judges in *Malone*. Justice Douglas, writing the dissent, pertinently stated as follows:

> The Court is quite correct in saying that all of our decisions in this field cannot easily be reconciled; and the same will doubtless be true if said by those who sit here several decades hence. The reason the decisions are not consistent is that policy considerations, not always apparent on the surface, are powerful agents of decision. Thus the *Larson* case was a suit for specific performance of a contract to sell coal, a matter that courts had long

[3] See Legislative History, *supra*.

left to damage suits. As I said in my separate concurrence in that case, any other rule would "clog" government procurement "with intolerable burdens." 337 U.S., at 705.

Ejectment, on the other hand, is the classic form of action to try title. It takes place in the locality where the land is located. No judges are better qualified to try it than the local judges. It is a convenient and ready form of remedy for possession of land. Moreover, the United States, not being a party, is not bound by the state court decree. If it is aggrieved by the state or federal court ruling on title, it can bring its arsenal of power into play. Eminent domain—with the power immediately to take possession—is available.

If, however, the citizen must bow to the doctrine of sovereign immunity, he is precluded from any relief except a suit for damages under 28 U.S.C. § 1346(b) or 28 U.S.C. § 1346(a)(2), or 28 U.S.C. § 1491. This places the advantage with an all-powerful Government, not with the citizen. He may, as the Court says, go into court and get the value of his property. *But he does not get his property, even though we assume, as we must, that the Government is not the rightful claimant.* [Emphasis supplied.] [369 U.S. at 650–651.]

And, similarly, in *Larson* v. *Domestic & Foreign Corp.*, *supra*, at 722–723, Justice Frankfurter stated:

* * * When there is such a special remedy the suit against the officer is barred, not because he enjoys the immunity of the sovereign but because the sovereign can constitutionally change the traditional rules of liability for the tort of the agent by providing a fair substitute. *Crozier* v. *Fried*, 224 U.S. 290; *Richmond Screw Anchor Co.* v. *United States*, 275 U.S. 331. *But the general statute permitting suit in the Court of Claims in certain instances against the Government is not a statute that provides that remedies otherwise at the plaintiff's command are to be displaced.* A holding that the availability of an action for monetary damages in the Court of Claims against the United States prevents a suit at law, or, if the necessary requisites for equity jurisdiction are present, in equity, against the governmental agent, would be as novel as it is indefensible in the light of the settled course of decisions. Indeed, this argument is not novel; it has been explicitly negatived in at least two cases. See *Sloan Shipyards Corp.* v. *United States Fleet Corp.*, 258 U.S. 549, 567, 568; *Land* v. *Dollar*, 330 U.S. 731, 738. [Footnote omitted.] [Emphasis supplied.]

As pointed out in the two passages from the dissenting opinions of the Court above quoted, the remedy available in the Court of Claims under section 1491 is not truly adequate in that:

> * * * he [plaintiff] does not get his property, even though we assume, as we must, that the Government is not the rightful claimant.

Pub. L. 92–562 is a well-drafted legislation and it is my opinion that the legislation is intended to correct not only the harsh results of the defense of sovereign immunity by the waiver of such defenses but it provides a quiet title proceeding to erase the inequity of forced relinquishment of title to Government under the Court of Claims procedure to which Justice Douglas rightly protested.

At this point I believe it is significant to note that an action brought under § 1491 is subject under 28 U.S.C. § 2501 to a six-year statute of limitations but when the same action is filed under the quiet title section, the period of limitations is 12 years. Section 2409a(f) provides as follows:

> (f) Any civil action under this section shall be barred unless it is commenced within twelve years of the date upon which it accrued. Such action shall be deemed to have accrued on the date the plaintiff or his predecessor in interest knew or should have known of the claim of the United States.

The majority's opinion would permit the application of the six-year period of limitations if the quiet title action is brought in this court, but a 12-year period would be applicable to the same cause of action if the action is brought in the Federal District Courts. Such a construction which leads to two conflicting periods of limitation is absurd. We have held that absurd results of interpretation of a statute should be avoided. *Kantor* v. *United States*, 205 Ct. Cl. 1 (1974); *Tlingit and Haida Indians of Alaska* v. *United States*, 147 Ct. Cl. 315, 177 F. Supp. 452 (1959); *Jennings* v. *United States*, 144 Ct. Cl. 28, 168 F. Supp. 781 (1958). It is submitted that this absurdity can be resolved by construing Pub. L. 92–562 to mean that after its enactment, actions to quiet title like the present action must be brought in the Federal District Courts and not in the Court of Claims. It is submitted that where

there are several related statutes, they should be so construed, if possible, by a fair and reasonable interpretation so as to give full force and effect to each and all of them. *United States* v. *American Trucking Association*, 310 U.S. 534, 543 (1940); *United States* v. *Borden Co.*, 308 U.S. 188, 198 (1939); *Posadas* v. *National City Bank*, 296 U.S. 497, 503 (1936); *Jamerson* v. *United States*, 185 Ct. Cl. 471, 475, 401 F. 2d 808, 810 (1968); *Frizzell* v. *United States*, 123 Ct. Cl. 337, 341 (1952).

Another consideration which I consider important is that in any taking case, the court must first decide whether the plaintiff owns title to the land allegedly taken. This title issue as a preliminary matter is more appropriately litigated in a quiet title proceeding brought in a District Court, wherein all parties interested in the land can be made parties to the case. Because there are various owners to lots surrounding the island at issue, they should all be heard in one action.

It is also of interest that Pub. L. 92–562 further amended 28 U.S.C. § 1402 by adding subsection (d), which reads as follows:

> (d) Any civil action under section 2409a to quiet title to an estate or interest in real property in which an interest is claimed by the United States shall be brought in the district court of the district where the property is located or, if located in different districts, in any of such districts.

In this respect I agree with Justice Douglas' statement that "No judges are better qualified to try it [real property title] than the local judges." *Malone* v. *Bowdoin*, *supra*, at 650. Where the subject matter of the litigation is real property, it appears equitable that suit be brought and tried in a court near the situs of the property. This consideration is further strengthened by the fact the majority recognized that the State law, not the Federal law, of real property applied to decide some of the basic issues presented. In addition, the District Court has jurisdiction to resolve the complete matter in one proceeding and to provide a remedy under § 2409a.

I, therefore, dissent from the majority opinion that this court has jurisdiction over this case.

Syllabus

Furthermore, where, as in this case, defendant objects, for meritorious reasons as stated in this dissent, to the jurisdiction of this court and plaintiff is agreeable to a transfer, this court should, under 28 U.S.C. § 1506, transfer the action to the United States District Court for the Eastern District of Michigan.

---

## D. MICHAEL CRILE AND DOROTHEA MARY CRILE CARVEY v. THE UNITED STATES

[No. 331–73. Decided November 17, 1976]

ON PLAINTIFFS' AND DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

**Taxes; estate tax; inclusions in gross estate; revocable transfers.**—Plaintiffs seek refund of Federal estate taxes, plus interest. The sole issue is whether the corpus of a 1918 trust established by decedent pursuant to a marriage indenture agreement is includable in her gross estate under 26 U.S.C. § 2038. It is *held* that in view of Article 6 of the trust pursuant to which decedent could name herself or some other person to designate which of her children were to receive the corpus of the trust, at what time and in what shares, decedent's power was within the scope of Sec. 2038(a)(2). Accordingly, the amount included in her gross estate is the value of the interest which is subject to the taxable power, and since decedent retained a taxable power over the entire property transferred in this case, its entire value is includable in the estate. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

**Taxes; estate tax; gross estate, inclusions in; revocable transfers; power to alter, amend, revoke or terminate.**

[1] Sec. 2038 of the Internal Revenue Code of 1954 is intended to cover any transfer of property which is subject to a later change in beneficial enjoyment by the donor, and is applicable to any power affecting the time or manner of enjoyment of property or its income.

Internal Revenue ⇐ 1004

**Taxes; estate tax; gross estate, inclusions in; revocable transfers; power to alter, amend, revoke or terminate.**

[2] Where the 1918 trust set up by decedent allowed her, as the surviving settlor, to appoint herself or any other person to select which of her children would receive the final distribution of her estate, their respective shares and the time of receipt, the corpus of the trust is includable in decedent's gross estate for estate tax purposes pursuant to Sec. 2038(a)(2) of the Code, notwithstanding

that the power was exercisable only in conjunction with a trustee and that the power retained by decedent had no saleable value.

Internal Revenue ⟸ 1004

**Taxes; estate tax; gross estate, inclusions in; revocable transfers; power to alter, amend, revoke or terminate; general power of appointment.**

[3] Sec. 2038 of the Code is not limited by Sec. 2041; the two provisions are independent.

Internal Revenue ⟸ 1002, 1004

*D. Michael Crile, pro se.*

*Patricia B. Tucker*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Robert S. Watkins*, of counsel.

---

Before SKELTON, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: Plaintiffs, D. Michael Crile and Dorothea Mary Crile Carvey, beneficiaries of the estate of Mary Crile, filed a *pro se* petition in this court seeking a refund of Federal estate taxes in the amount of $13,091, plus interest. The sole issue is whether the corpus of a trust established by the decedent, pursuant to a marriage indenture agreement of December 29, 1918, is includable in her gross estate under 26 U.S.C. § 2038 because of her reservation of powers to alter, amend, or revoke the trust.

Plaintiffs filed a supplemental pleading and a motion for judgment on the pleadings, which is in effect a motion for summary judgment. Defendant has filed a motion for summary judgment. Plaintiffs have responded to defendant's motion. The case is thus actually before the court on cross motions for summary judgment.

26 U.S.C. § 2038, Revocable Transfers, provides in pertinent part, as follows:

> (a) In general.—The value of the gross estate shall include the value of all property—
>
> * * * * *
>
> (2) TRANSFERS ON OR BEFORE JUNE 22, 1936.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoy-

ment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death. * * *

The property transferred in this case was decedent's beneficial interest in an earlier trust established by her parents, which she transferred in 1918 into a trust pursuant to a marriage indenture agreement. The case turns on whether the decedent held at the time of her death any power to "alter, amend, or revoke" the terms of the trust within the scope of § 2038(a)(2).

Defendant, in its motion for summary judgment, contends that decedent, at the time of her death, held the power to alter, revoke, or amend the 1918 trust in three ways: (1) under Article 6, decedent could name herself or some other person to designate which of her children were to receive the corpus of the trust, at what time, and in what shares; (2) under Article 8 of the trust, decedent and the trustees could pay out up to one-half of the presumptive shares of decedent's children prior to her death; and (3) under Article 15, decedent could withdraw up to one-half of the corpus and appoint it for the benefit of subsequent husbands and the issue of subsequent marriages. Defendant urges that the portion of the corpus of the 1918 trust attributable to the decedent's contribution to the trust be included in her gross estate under § 2038(a)(2) of the Internal Revenue Code of 1954.

Generally, § 2038 is intended to cover any transfer of property which is subject to a later change in beneficial enjoyment by the donor. *Lober* v. *United States*, 346 U.S. 335 (1953). Section 2038 is applicable to any power affecting the time or manner of enjoyment of property or its income. Treas. Reg. § 20.2038–1.

Defendant must prevail because Article 6 of the trust allowed the decedent, as the surviving settlor, to appoint herself or any other person to select which of her children would receive the final distribution, their respective shares, and the time of receipt. Thus, the decedent had the power to shift the economic enjoyment of the property held in trust. The

retained power to vary shares among named beneficiaries and the included power to eliminate a named beneficiary have been held to be sufficient powers to include the trust property in the donor's estate. *Hoblitzelle* v. *United States*, 77 Ct. Cl. 639, 3 F. Supp. 331 (1933); *Union Trust Co. of Pittsburgh* v. *Driscoll*, 138 F. 2d 152 (3d Cir. 1943), *cert. denied*, 321 U.S. 764 (1944).

The powers reserved under Article 6 pertain to the entire amount in issue. Since the entire trust should be included pursuant to the decedent's powers under Article 6, we do not need to consider Articles 8 and 15.

Plaintiffs argue that: (1) decedent did not have any dispositive powers over the corpus, but could only request action by the trustees or consent to such action; (2) 26 U.S.C. § 2041 limits the application of 26 U.S.C. § 2038; (3) no transfer of property occurred, and that if it did, the transfer created only a contingent interest in the decedent's husband which failed when he predeceased her; and (4) the powers retained by decedent had no salable value and could not be included as an increase in the value of the estate. Each of these contentions is discussed below.

First, the fact that a given power was exercisable only in conjunction with a trustee does not change the result. *Flood* v. *United States*, 133 F. 2d 173 (1st Cir. 1943). Second, § 2041 is not pertinent. Section 2041 provides generally that the gross estate of a decedent shall include property over which the decedent held a general power of appointment under certain circumstances. Defendant's case does not rely on this provision to include the trust in the gross estate. Plaintiffs seem to argue that § 2041 limits § 2038; however, the two provisions are independent. Treas. Reg. § 20.2041–1(b)(2). Third, the plaintiffs in this case received the trust corpus and the fact that decedent's husband did not receive an interest in the trust is irrelevant. Fourth, property which the decedent could not have sold is often included in his estate and should be included here.

It should be noted in passing that § 2036 entitled "Transfers with Retained Life Estate" is not applicable since the transfer was completed prior to March 4, 1931, the effective date of the provision. 26 U.S.C. § 2036(b).

Syllabus

The amount included in the decedent's gross estate under § 2038 is the value of the interest which is subject to the taxable power. Since the decedent has retained a taxable power over the entire property transferred in this case, its entire value is included in the estate.

Therefore, on consideration of the record and briefs, but without oral argument, plaintiff's motion for summary judgment is denied. Defendant's motion for summary judgment is granted. The petition is dismissed.

---

## TRUONG XUAN TRUC, FAR EAST COMPANY, TRUONG GIANG, KIEN THIET ENTERPRISES, MAI-ANH, NGUYEN KHAC TRUONG, CONG-TICH CONG-TY, VANACO, WYANCO, AND TRUONG XUAN TRUC v. THE UNITED STATES

[Nos. 453–72 through 457–72 and 459–72 through 463–72. Decided November 17, 1976]

ON DEFENDANT'S AND PLAINTIFFS' MOTIONS FOR SUMMARY JUDGMENT

**Contracts; interpretation; payments clauses; legal rate of exchange.**—These consolidated cases are before the court from a decision of the Armed Services Board of Contract Appeals denying plaintiffs' claims for additional compensation relative to performance of firm, fixed-price contracts for construction of a hospital, sewers, etc. in South Vietnam, awarded during the period December 29, 1966 and August 28, 1967. Final payments on all the contracts were received after October 1, 1967, on which date under a Vietnam Decree Law the United States Government became eligible to purchase piasters at the exchange rate of 118 to 1. Plaintiffs' bid proposals were stated in Vietnamese piasters; the formal contracts as initially awarded stated the contract prices in U.S. dollars at the official conversion rate of 80 to 1, and the contract payments were in piasters using the 80 to 1 rate. Plaintiffs claim that the exchange rate should have been calculated at a conversion rate of 118 to 1. The payments clauses provided that the United States reserved the right to make payments in Vietnamese piasters at the legal rate of exchange in effect on the date approved invoices were presented to the finance officer for payment. It is *held* that utilization by the parties of the exchange rate of 80 to 1 in negotiating and executing the contracts manifested an understanding that the language in the payment clauses "legal rate of exchange" was synonymous with

the "official rate of exchange" language of the Vietnamese Decree Laws and International Monetary Fund Reports; that the payment clauses anticipated conversion at the official rate of 80 to 1; that this rate was the legal rate of exchange referred to in the clauses; that the legal rate of exchange contemplated by the parties remained the same throughout performance of the contracts; and that since plaintiffs received payment at this rate they are not entitled to any further recovery. Defendant's motion for summary judgment is granted, plaintiffs' cross-motion is denied, and the petitions are dismissed.

**Contracts; disputes; administrative record; supplementation of record.**

[1] In Wunderlich Act review cases the parties, as a general rule, cannot supplement the record with additional fact-oriented materials not placed before the administrative board initially, and this is so in cases where the dispositive issue is deemed to be one of law.

United States ⊂⊃ 73(15)

**Contracts; interpretation; conduct of parties as aid to.**

[2] In ascertaining the meaning of a contract clause, the harmonious conduct of the parties and attendant circumstances prior to an occurrence pertinent to the dispute provide some insight into the parties' underlying intention relative to said clause.

Contracts ⊂⊃ 147(1)

**Contracts; interpretation; intention of parties to contract.**

[3] Where the dispute concerns the proper exchange rate to be utilized for payments under the contract clauses in issue, the fact that some payments were initially processed at the rate now contended for by the contractor has no probative value relative to evidence of the intention of the parties where four different contracting officers were involved which tended to generate differences of opinion as to payments and the payments were made in a period of uncertainty and confusion in Vietnam.

United States ⊂⊃ 70(15)

**Contracts; interpretation; generally.**

[4] Contract provisions should be construed, if possible, to be lawful rather than unlawful.

Contracts ⊂⊃ 153

**Contracts; disputes; administrative decision; finality of on question of law.**

[5] Interpretation of the meaning of a contract involves a question of law to be determined by the court unfettered by any prior administrative determination. This does not mean that an erroneous legal determination by the administrative board adverse to the contractor warrants a judgment in his favor.

United States ⊂⊃ 70(1)

Syllabus

**Contracts; interpretation; reasonable interpretation.**

[6] The language of a contract must be accorded the meaning derived from the contract by a reasonably intelligent person acquainted with the contemporary circumstances.

Contracts ⟸ 152

**Contracts; interpretation; intention of parties to contract.**

[7] The ultimate goal of the court is always to give full force and effect to the expressed or implied intentions of the contracting parties, if such can be discerned.

Contracts ⟸ 147(1)

**Contracts; interpretation; payment provisions; legal rate of exchange.**

[8] Where the bid proposals prepared by the contractors were submitted in piasters on the basis of an 80 to 1 exchange rate, the bids were accepted and converted into dollars at the official 80 to 1 rate, and the parties signed their contracts with the consideration expressed in dollars, which dollar figures resulted from use of the 80 to 1 conversion rate, by selecting said rate the intent of the parties was that the legal rate of exchange contemplated in the payment clauses was the official 80 to 1 rate, which remained the same throughout contract performance.

Payment ⟸ 12(5)

**Contracts; Government obligation to contractor; payment provisions; legal rate of exchange.**

[9] The fact that the United States Government in its sovereign capacity was permitted by the South Vietnamese Government to purchase in South Vietnam a greater number of piasters for one dollar than the official legal exchange rate during a period before final payments were received by the contractors on the subject contracts, did not require the United States, absent a specific contractual obligation, to pass this subsidy along to the contractors, since the official legal exchange rate remained throughout contract performance at the 80 to 1 figure contemplated by the payment clauses.

United States ⟸ 70(15)

**Contracts; parties; Government contract.**

[10] In the domains of commerce the Government and the contractor are on equal footing and subject to the same laws that govern individuals. Both must turn square corners in their dealings with each other.

United States ⟸ 63

**Contracts; damages; measure of damages; quantum meruit.**

[11] There can be no recovery on the theory of quantum meruit as an alternative legal basis for recovery where there are valid express contracts between the parties.

Work and Labor ⟸ 9

**Fraud; Government agents, fraud of; evidence sufficient to establish; generally.**

[12] Well-night irrefragable proof is necessary to support fraud charges directed at Government officials.

Fraud ⇐ 58(1)

*James M. O'Neill*, attorney of record, for plaintiffs. *James T. Sharkey*, of counsel.

*Peter A. T. Sartin*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: These cases come before the court on plaintiffs' request, filed April 19, 1976, for review by the court of the recommended decision of Trial Judge Thomas J. Lydon, filed February 24, 1976, pursuant to Rule 166(c) on defendant's motion and plaintiffs' cross-motion for summary judgment and on defendant's motion, filed May 14, 1976, requesting the court to adopt the said recommended decision. Upon consideration thereof, together with the opposition thereto and the briefs and oral argument of counsel, since the court agrees* with the trial judge's recommended decision, as hereinafter set forth, it hereby denies plaintiffs' request for review, grants defendant's motion to adopt and adopts and affirms the decision as the basis for its judgment in this case. Therefore, plaintiffs' cross-motion for summary judgment is denied, defendant's motion for summary judgment is granted and the petitions are dismissed.

OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* These ten cases have been consolidated for decision since they involve similar factual situations and present an identical legal question for determination. While the pleadings, motions and briefs of the parties raise a number of issues and advance a variety of arguments, analysis indicates that the basic dispositive issue, central to all ten cases, concerns the legal interpretation to be given the so-

*NICHOLS, *Judge*, concurs in the result.

called payment provision clauses contained in the construction contracts awarded the ten plaintiffs, South Vietnamese contractors, by defendant, acting through the Department of the Navy.[1]

The ten contracts in issue provided for the "Construction of Force Structure Increases," and involved the construction in the Republic of South Vietnam of a hospital, sewers, latrines, billets, etc. All the contracts were negotiated firm fixed price, or lump sum, contracts. The bid proposals submitted by the plaintiffs were stated in Vietnamese currency, *i.e.*, piasters. However, the formal contracts, as initially awarded plaintiffs, stated the contract prices in United States currency *i.e.*, dollars.[2] In three instances (Ct. Cl. Nos. 455–72, 457–72 and 461–72), contracts were subsequently modified and amended so as to state the contract prices in piasters instead of dollars. There is no explanation in the records for these modifications, which took place in August and September 1968, and no conclusion can be, or is, drawn relative thereto. It is established that all contract payments made to the plaintiffs were in piasters. This was accomplished by defendant converting dollars into piasters, utilizing an exchange rate of 80 piasters for each dollar (hereinafter 80 to 1).

Before the Armed Services Board of Contract Appeals (hereinafter the Board), plaintiffs claimed entitlement to additional compensation relative to the contracts they performed on the basis that the amounts paid them in piasters should have been calculated at a conversion rate of 118 piasters to the dollar (hereinafter 118 to 1) instead of at the

[1] The parties insist that the issue in these cases is a simple one and each, at some point in their briefs, argue that the decision herein should turn on the construction and/or interpretation to be placed on the payment provisions of the contracts in question.

[2] The bid proposals in piasters were converted by defendant into the contract dollar prices by utilizing an exchange rate of 80 piasters to the dollar (hereinafter 80 to 1). For example, in the *Truong Xuan Truc* case (Ct. Cl. No. 463–72, the bid proposal of some 11,845,000 piasters was converted into the stated contract dollar price figure of $148,062. It is interesting to observe that if an exchange rate of 118 piasters to the dollar (hereinafter 118 to 1) was utilized by defendant in converting the bid proposal into the stated contract dollar price figure, the contract price would have been $100,381. The significance of this observation will become apparent when the contract interpretation contention of plaintiffs is considered *infra*.

rate of 80 to 1.[3] The Board denied plaintiffs' claims by decision dated October 27, 1971 (71-2 BCA ¶9149), and affirmed this decision, on plaintiffs' motion for reconsideration, on August 3, 1972. The plaintiffs thereafter filed ten separate petitions in this court challenging the Board's determinations.

The parties were proceeding under Rule 163(b), each having filed motions for summary judgment when said proceedings were interrupted on October 25, 1974, and subsequently suspended on March 6, 1975, in order to allow the parties time to resolve a possible conflict of interest which had surfaced involving the propriety of then counsel of record continuing to represent plaintiffs in the litigations. On April 22, 1975, notification was received that said counsel of record for plaintiffs was withdrawing from the litigations. The suspension order was lifted on April 25, 1975.

On June 27, 1975, James M. O'Neill filed a motion, under Rule 203(c), to be substituted as counsel of record for plaintiffs. In an affidavit which accompanied this motion, counsel advised that the prior attorneys of record for plaintiffs "have on behalf of plaintiffs requested him to take over all representational work in behalf of plaintiffs and to become counsel of record in all these cases." On or about April 30, 1975, the Government of the Republic of South Vietnam fell to communist forces. Counsel was unable to locate and/or contact nine of the ten plaintiffs involved herein. Counsel was able to locate in the Washington, D.C., metropolitan area one Dao Van Quang, the owner and principal officer, of Vanaco, plaintiff in Ct. Cl. No. 461-72, who ratified and approved the substitution of James M. O'Neill as attorney of record for Vanaco by affidavit dated August 4, 1975. In this affidavit, Dao Van Quang stated that for 2 years prior to his departure

[3] In the *Truong Xuan Truc* case (Ct. Cl. No. 463-72), *supra*, the final contract price stated in dollars was $148,739.97. Truc was paid some 11,899,198 piasters, representing a conversion rate of 80 to 1. Truc, before the Board, claimed that it should have been paid some 17,551,316 piasters, representing a conversion rate of 118 to 1. Accordingly, Truc sought to recover the difference between the above figures, *i.e.*, an additional 5,652,118 piasters. It is apparent that the seed for the dispute between the parties was sown when defendant, for reasons not entirely clear in the Board records, stated the contract price in dollars instead of in piasters. Had plaintiffs' bid proposal figures, which were stated in piasters, been, on acceptance, stated in piasters in the contracts, it would have been obvious that plaintiffs were being paid the exact amount of piasters for which they agreed to do the work.

from Vietnam he was in frequent contact with the other plaintiffs, had acted as spokesman for the entire group of contractors and voiced his personal knowledge and belief that at the time he departed Vietnam all plaintiffs intended to proceed with the litigations.[4]

Subsequent to August 4, 1975, the parties filed their concluding briefs thereby presenting the cases for decision.[5]

## I

All of the contracts here in issue were awarded during the period December 29, 1966, and August 28, 1967, and ranged in amounts from $21,171 to $249,306.75.[6] The contracts were entered into on defendant's behalf by four different contracting officers. The original completion dates contemplated in the contracts varied from about 2½ months to 5 months from date of notice to proceed or commencement dates. The commencement dates did not vary significantly from the award dates. While all of the contracts were awarded on or before

[4] Defendant suggests that since counsel has no express direct authority from nine plaintiffs to continue the litigations, an adverse decision against them now may be challenged at a later time on grounds counsel was not personally authorized to represent them. However, plaintiff Vanaco has authorized counsel to represent it by action of its owner and principal officer. *Cf. Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 662, 428 F. 2d 1241, 1249 (1970). Since a common issue is involved in all the cases, a decision in one case will be dispositive of all cases, and this fact serves to blunt the thrust of defendant's suggestion. Defendant has not raised any question as to the capacity of the corporate plaintiffs to maintain actions in this court. *See Mather Constr. Co.* v. *United States*, 201 Ct. Cl. 219, 222–25, 475 F. 2d 1152, 1154–56 (1973).

[5] In addition to these 10 cases there are 13 other cases, referred to as the lease cases, presently pending in this court which also center on the correct rate of exchange to be applied relative to converting dollars into piasters. It is also understood that there are presently other cases pending before the Board which involve this same issue.

[6] The facts relied on herein are either found by the Board or otherwise undisputed and contained in the Board records. Neither party has effectively established that the Board erred on any significant factual finding. Both parties have submitted documentary materials in support of their respective summary judgment motions which were not submitted to the Board. None of these materials were considered helpful relative to the court's task of interpreting the disputed clauses of the contracts in issue. Moreover, in Wunderlich Act review cases the parties, as a general rule, cannot supplement the record with additional fact-oriented materials not placed before the Board initially, and this is so in cases where the dispositive issue is deemed to be one of law. See *Roscoe-Ajax Constr. Co.* v. *United States*, 198 Ct. Cl. 133, 149, 458 F. 2d 55, 64 (1972); *Northbridge Electronics, Inc.* v. *United States*, 195 Ct. Cl. 453, 463–64, 444 F. 2d 1124, 1130 (1971). Accordingly, the extraneous nonrecord material proffered by the parties played no part in the decision reached herein.

August 29, 1967, only three contracts (*i.e.*, those involved in Ct. Cl. Nos. 455–72, 457–72 and 461–72) were originally scheduled to be completed after October 1, 1967. However, actual work completion dates, as distinguished from dates when final payments were received, were from 4 months to as much as 13 months after the commencement dates. It is difficult to ascertain from the records the actual work completion dates of each contract but it is safe to say that most of the contracts were completed after October 1, 1967. It is clear that final payments on all the contracts were received after October 1, 1967. The significance of the October 1, 1967, date will appear hereafter.

It is important to bear in mind that plaintiffs' bid proposals were submitted in piasters. The final formal contract between the parties stated the contract price in dollars. The dollar amounts were arrived at by converting the piaster figures set out in plaintiffs' accepted proposals at the exchange rate of 80 to 1. The final formal contracts were executed by the parties and clearly manifest their intent that the rate of exchange utilized by them in formulating the contracts was 80 to 1.

Nine of the ten contracts here in question contained the following clause:

> The consideration under this contract in the lump sum amount of [stated contract price in dollars] is expressed in U.S. Dollars; however the United States Government reserves the right to make payments in Vietnamese Piastres at the *legal rate of exchange between the U.S. Dollars and Vietnamese Piastres in effect on the date approved invoices are presented to Finance Officer for payment.* [Emphasis added.]

The clause in the remaining case (Ct. Cl. No. 453–72) is identical to that quoted above up to and including the word "exchange," after which it concludes as follows:

> * * * *between the two currencies in effect at the time any invoice is presented for payment.* [Emphasis added.]

It is the above clauses, especially the underscored portion, on which the decision in these cases must rest. The parties do not attach any significance to the different wording of the two clauses, *supra*, and such language differences as exist can

rightly be considered immaterial. The Board observed that neither party offered evidence to show any discussion during negotiation of the contracts concerning the reason for including the above clauses in the contracts, nor was any evidence offered as to why the contract prices were stated in dollars rather than piasters. There was no testimony submitted to the Board nor any Board hearing in the adversary sense. The Board rendered its decision on a record composed only of documents. *See Blanchard* v. *United States*, 171 Ct. Cl. 559, 567, 347 F. 2d 268, 273 (1965).

The Board utilized excerpts from the Eighteenth and Nineteenth Annual Reports on Exchange Restrictions, 1967 and 1968, published by the International Monetary Fund, which excerpts were before the Board on stipulation of the parties, to establish the exchange rate system prevailing in South Vietnam during the period the contracts in question were negotiated and executed by the parties and thereafter. In substance, the official rate of exchange prevailing at the time the contracts were negotiated and executed was 80 to 1. Parenthetically, this was also the rate at which the United States was authorized by the Government of the Republic of South Vietnam to buy piasters in South Vietnam. There also existed another rate of exchange called a "Consolidation Premium" or a "Consolidation Tax," which consisted of a subsidy of 38 piasters to the official rate of exchange of 80 piasters to produce a rate of exchange of 118 to 1. This subsidy, which was made available to selected entities by the Government of South Vietnam, enabled those entities to purchase piasters in South Vietnam at the exchange rate of 118 to 1. The United States Government was not one of the entities to which the 38-piaster subsidy was made available at the time the contracts in question were negotiated and executed. Both these rates of exchange were provided for by Republic of Vietnam Decree Law No. 001/SLU and Decree Law No. 002/SLU issued June 18, 1966. In essence, both exchange rates can be considered legal rates since both were promulgated by the Government of South Vietnam. There also existed in South Vietnam at the time the contracts were negotiated and executed an illegal free exchange market rate (black market rate of exchange) which was in excess of 118 to 1. It seems clear that very few, if any, private transactions

took place at the rate of 80 to 1 and that the exchange rate of 118 to 1 was the rate at which most transactions occurred. This, in essence, was the exchange rate situation that prevailed in South Vietnam when the contracts were negotiated and executed.

It is not unreasonable to charge both defendant and plaintiffs with knowledge of the exchange rate system prevailing in South Vietnam at the time the contracts in question were negotiated and executed. Further, it seems reasonable to conclude that utilization by the parties of the exchange rate of 80 to 1 in negotiating and executing the contracts manifested an understanding that the language in the payment clauses, "legal rate of exchange," was synonymous with the "official rate of exchange" language in the Republic of Vietnam Decree Laws and the above-referenced International Monetary Fund Reports. This conclusion is reinforced when it is noted that two legal rates of exchange were in existence when the parties entered into the contracts in question. The selection by the parties of one of two existing legal rates of exchange pinpoints rather clearly the legal rate of exchange they agreed to abide by.[7]

Plaintiffs submitted vouchers and/or invoices for payment in connection with performances of their contracts. Some vouchers were presented in piaster amounts and others were submitted in dollar amounts. There is nothing in the Board records to indicate why some vouchers were submitted in piasters while others were submitted in dollars. With reference to those vouchers presented in piasters, plaintiffs were paid the requested amounts (assuming arithmetical accuracy). If a voucher was presented in a dollar amount, that amount was converted into piasters by utilization of an exchange rate of 80 to 1, and the contractor was paid, in piasters, the product of that multiplication. In either case, defendant's approving official, a finance or fiscal officer, generally showed on the payment voucher the amount approved

[7] Moreover, it would be unreasonable to expect that defendant would have expressly agreed to pay plaintiffs at the conversion rate of 118 to 1 at a time when it could only purchase piasters at the conversion rate of 80 to 1. *See Bateson-Stolte, Inc.* v. *United States*, 158 Ct. Cl. 455, 460, 305 F. 2d 386, 389 (1962).

both in dollars and piasters as well as the exchange rate at which the conversion was computed. In the "Accounting Classification" section of the vouchers, in addition to appropriate budgetary and accounting information, the dollar amount only was shown. As a result, before October 1, 1967, when a conversion was accomplished in processing payment vouchers received from plaintiffs at the exchange rate of 80 to 1, that exchange rate was also the basis for determining the amount expended from defendant's contracting agency appropriation account.

The harmonious conduct of the plaintiffs, relative to contract billings and acceptance of contract payments by them prior to October 1, 1967, persuades that prior to said date all parties concerned considered the legal rate of exchange, as that language was used in the contracts, to be 80 to 1. *See Cresswell* v. *United States*, 146 Ct. Cl. 119, 126, 173 F. Supp. 805 (1959). Further the conduct of the parties and attendant circumstances prior to October 1, 1967, provide some insight into the parties' underlying intention relative to the meaning to be given the clauses in question. *Macke Co.* v. *United States*, 199 Ct. Cl. 552, 556, 467 F. 2d 1323, 1325 (1972).

By Republic of Vietnam Decree Law No. 035/SLU issued August 29, 1967, effective on and after October 1, 1967, the South Vietnamese Government extended the "Consolidation Premium," or subsidy of 38 piasters, mentioned previously, to all financial and commercial transactions from abroad to South Vietnam. As a result, effective October 1, 1967, the United States Government became eligible to purchase piasters at the exchange rate of 118 to 1. It is the issuance of this Decree Law which set in motion the present litigations.

Plaintiffs assert that as of October 1, 1967, the "effective legal rate" of exchange changed from 80 piasters to 118 piasters to the dollar, and that under the above payment clauses, defendant became obligated to convert contract dollars into piasters at the new and higher rate of 118 piasters for each contract dollar. Plaintiffs maintain that since defendant, subsequent to October 1, 1967, was able to purchase 118 piasters for every dollar and yet only paid plaintiffs at the rate of 80 to 1, defendant will receive a windfall of

38 piasters for every contract dollar expended subsequent to October 1, 1967, unless plaintiffs are allowed recovery herein.[8]

With respect to payment vouchers and/or invoices submitted after October 1, 1967, there was some confusion and uncertainty generated by the availability to the United States Government of the 38-piaster subsidy in its purchase of piasters with dollars. When the payment vouchers submitted by plaintiffs were stated in piasters, plaintiffs were paid, as was the case prior to October 1, 1967, the number of piasters shown thereon. In the approval section of the voucher, the amount was approved both in piasters and in dollars at a conversion rate of 80 to 1. However, the amount charged to the contracting agency's appropriation account was a dollar figure arrived at by utilization of a conversion figure of 118 to 1. This, of course, resulted in less of a dollar drain on the appropriation available to the agency. When the voucher was stated in dollars, the paying officer generally would effect a conversion to piasters at the rate of 80 to 1 and pay the piaster product of this multiplication to the contractor. The approval section of the voucher, in such an instance, showed the dollar amount claimed by the contractor, the amount of piasters paid to the contractor and a conversion rate figure of 80 to 1.[9] As indicated above, the account-

[8] Before the Board, plaintiffs sought to have the higher rate of exchange applied to all contract payments both before and after October 1, 1967. While not crystal clear from plaintiffs' pleadings and briefs, a fair reading thereof suggests that plaintiffs' claims germinated on October 1, 1967, and that the claims they advance herein may be viewed as directed only at approved invoices presented for payment on and after October 1, 1967.

[9] There were some instances where plaintiffs were paid in piasters at a conversion rate of 118 to 1 and the approval section of the voucher reflected a conversion figure of 118 to 1. However, these vouchers were subsequently recalculated, utilizing a conversion rate of 80 to 1, and the overpayment differences recouped from the contractors in connection with later payments under the same contracts. The fact that some payments were initially processed at the 118 to 1 rate has no probative value relative to evidence of the intention of the parties. The fact that four different contracting officers were involved in these ten cases may well have generated a difference of opinion as to how the matter should be handled. These payments were made in a period of uncertainty and confusion and merit no consideration in the process of interpreting the clauses in question. *See Jansen* v. *United States*, 170 Ct. Cl. 346, 354–55, 344 F. 2d 363, 369 (1965). This same observation is also applicable to those few instances where equitable adjustments for ordered changes were negotiated in dollar amounts by converting piaster proposals at the 118 to 1 rate. In these instances a reconversion to piasters was made at the time of payment on the same 118 to 1 basis. Without more, these negotiations are such that it cannot be said that defendant consented to plaintiffs' view regarding

(Continued)

ing classification section of the voucher showed a lesser dollar amount as chargeable to the appropriation account (because of use of the 118 to 1 rate), than appeared in the approval section of the voucher (because of the use of the 80 to 1 rate). On some vouchers, the difference between the dollar amounts claimed by the contractors and that charged to the appropriation account was shown in the "Differences" section of the voucher. In some instances vouchers were submitted by plaintiffs stating the amount due in piasters, but supported by invoices stated in dollars, which were converted into the piaster amount claimed at the rate of 118 to 1. In these instances, defendant's fiscal or finance officer recalculated the dollar invoices for conversion at the rate of 80 to 1 and reduced the piaster claimed amount accordingly. However, the piaster amounts paid to the contractors were then reconverted to dollars for the purpose of appropriation accounting at the rate of 118 to 1. Plaintiffs point to these internal bookkeeping and accounting activities of defendant as evidence of the "windfall" they allege defendant has reaped from these contracts.

II

The Board avoided the task of interpreting the payment clauses, cited *supra*, by holding that such clauses were invalid and/or unenforceable because, in the Board's view, Vietnamese persons and firms were forbidden to sign contracts with the United States in which the consideration was expressed in United States dollars.[10] However, this holding, the Board continued, did not affect the validity of the remaining portions of the contract. Thereafter, the Board noted that plaintiffs' proposals were cast in piaster amounts; that plaintiffs were paid in piasters, in the amounts so proposed; and concluded plaintiffs had received full payment and were entitled to nothing further. The Board refused to allow the

(Continued)
the proper exchange rate to be utilized relative to the contracts' clauses in question. The basic dispute remained for future resolution. *See Lockheed Aircraft Corp.* v. *United States*, 192 Ct. Cl. 36, 44–45, 426 F. 2d 322, 326–27 (1970).

[10] The Board did observe, in its opinion on plaintiffs' Reconsideration motion, that "even if we decide that the payment clause was valid and enforceable, we should reach the same results as we did in the decision now under consideration."

complexity and confusion engendered by accounting conversions and reconversions from piasters to dollars to piasters to cloud the fact that, in its view, the contract amounts paid in piasters to plaintiffs were the same amounts in piasters for which plaintiffs proposed to perform their contracts, which proposals were accepted by defendant.

Defendant has conceded in its brief that the clauses in question are not invalid and unenforceable. The records and briefs before the court support this concession.[11] However, that concession does not resolve the matter. It merely means that the court must now interpret the disputed language of the clauses in question.

It is patently clear that the issues presented to and decided by the Board were legal issues. It is also clear that the issue now before the court, *i.e.*, interpretation of the disputed clauses of the contracts, is also a legal issue. It is firmly established that questions of law are to be decided by the court, *Beryllium Corp.* v. *United States*, 196 Ct. Cl. 12, 18–19, 449 F. 2d 362, 366 (1971), unfettered by any prior administrative determination. *Max Drill, Inc.* v. *United States*, 192 Ct. Cl. 608, 614, 427 F. 2d 1233 (1970). This does not mean, as plaintiffs seem to imply in their briefs, that an erroneous legal determination by the Board warrants judgments in their favor.

After careful consideration of the facts as found by the Board, or otherwise undisputed in the Board records, and the briefs of the parties, it is concluded that the payment clauses in question anticipated conversion at the official rate of 80 to 1, that this rate was the legal rate of exchange referred to in said clauses, and furthermore that this exchange rate never changed during the lives of said contracts. Since plaintiffs

[11] The Board decision was based on its reading of Republic of Vietnam Decree Law 017/SLU, September 3, 1966, which it believed required contracts in South Vietnam to state the consideration therefor in piasters, together with its reading of Article VIII(2)(b) of the Articles of Agreement of the International Monetary Fund to the effect that the United States agreed to abide by South Vietnam exchange laws. The Board felt that by expressing the contract consideration in dollars, an illegal and/or unenforceable contract resulted. Without elaboration, it would appear that the contracts in issue were not within the purview of Article VIII(2)(b) since they were not "exchange" contracts. Moreover, the contractors were paid in piasters which cast doubt on the Board's reading of Decree Law 017/SLU. In any event, the Board ostensibly failed to give due consideration to the proposition that contract provisions should be construed, if possible, to be lawful rather than unlawful. *See Hobbs* v. *McLean*, 117 U.S. 567, 576 (1886).

received payment at this rate for performing their contracts they are not entitled to any further recovery.

The court's task is to attribute meaning to the language in the payment clauses, "legal rate of exchange * * * in effect on the date approved invoices are presented * * * for payment." First, a determination must be made as to what legal rate of exchange was intended by the parties when they entered into the contracts, and thereafter determine what that rate was on the various dates when invoices were presented for payment.

The Board found that the parties did not submit any evidence as to the reasons for insertion of the clauses in the contract. The clauses were not standard government contract clauses. The plaintiffs argue that the clauses were designed to protect them against a devaluation [12] of the piaster, as well as to warn them that they would not be paid at the black market rate. Defendant suggests that the clauses were merely bookkeeping provisions to allow the government to charge dollars against its accounts while paying piasters to the contractors. There is no direct evidence in the records before the court in support of these contentions. It is noted in the Board records, however, that the official rate of 80 piasters to the dollar had replaced the old official rate of 35 piasters to the dollar on June 18, 1966. The first of the ten contracts in issue was awarded on December 29, 1966. Alert to this devaluation, it would not be unreasonable to view the clauses in question as an effort by the parties to cover themselves in the event of another change in the official rate of exchange.

It has been said that "the language of a contract must be afforded the meaning derived from the contract by a reasonably intelligent person acquainted with the contemporary

[12] It cannot be said that any devaluation of the piaster took place during contract performance for the official rate of exchange of 80 to 1 remained the same at all times material to these cases. *Cf. Mercantile Nat'l Bank* v. *United States*, 150 Ct. Cl. 700, 703, 280 F. 2d 832, 834 (1960), where the official rate of exchange between the United States dollar and the Mexican peso was affected by a devaluation of the peso which occurred during contract performances. Compare also *ITT Arctic Services, Inc.* v. *United States*, 207 Ct. Cl. 743, 524 F. 2d 680 (1975), where the Canadian Government terminated the fixed official rate of exchange between the Canadian dollar and other world currencies, including the United States dollar, by allowing the Canadian dollar to float in the international money market during contract performance. Neither of these cases, cited and relied on by plaintiffs, have applicability to the situation at hand.

circumstances." *Firestone Tire & Rubber Co.* v. *United States*, 195 Ct. Cl. 21, 30, 444 F. 2d 547, 551 (1971); *see also Kenneth Reed Constr. Corp.* v. *United States*, 201 Ct. Cl. 282, 288, 475 F. 2d 583, 586 (1973). Examination of the contemporary circumstances existing when the contracts were negotiated and executed provides a rather firm foundation on which to gauge the intention of the parties relative to the language in dispute. The ultimate goal of the court "is always to give full force and effect to the expressed or implied intentions of the contracting parties, if such can be discerned." *Massachusetts Port Authority* v. *United States*, 197 Ct. Cl. 721, 726, 456 F. 2d 782, 784 (1972).

As indicated earlier, three rates of exchange were utilized in South Vietnam at the time the contracts were negotiated and executed; *i.e.*, the official rate of 80 to 1, the consolidated premium rate of 118 to 1 (comprised of the official rate of 80 piasters plus the subsidy of 38 additional piasters), and the black market rate which was in excess of the 118 to 1 exchange rate. It is clear, as indicated previously, that the parties contracted with the official rate of 80 to 1 in mind. The bid proposals, in piasters, which were accepted and converted into dollars at the 80 to 1 rate confirm this fact. Since the contractors signed their contracts with the consideration expressed in dollars, which dollar figures resulted from use of the 80 to 1 conversion rate (*see* n. 2, *supra*), the intent of the parties is quite clear that the legal rate of exchange contemplated in the payment clauses of the contracts was the official rate of exchange, *i.e.*, 80 to 1. As indicated earlier, both the 80 to 1 rate and the 118 to 1 rate were legal rates existing at the time the contracts were entered into. By selecting the official rate of 80 to 1, the parties fingered the "legal rate of exchange" which was to govern contract payments.

The question which must be answered next is whether the "legal rate of exchange," within the purview of the payment clauses, ever changed during contract performance. The answer must be no. Plaintiffs, of course, point to October 1, 1967, when the United States was permitted to purchase piasters at the consolidated premium exchange rate (118 to 1) and argue that on this date the "effective" legal rate of exchange changed to 118 to 1. Plaintiffs use the word "effective"

to indicate that the 118 to 1 rate was the conversion rate used almost exclusively in transactions within South Vietnam. The flaw in plaintiffs' position in this regard is that this "effective" rate of 118 to 1 was in effect in South Vietnam prior to, during and after performance of the contracts in suit as will be demonstrated, *infra*. The record makes it clear that the official rate of 80 to 1 remained in effect after October 1, 1967. This is the important fact. The legal rate of exchange contemplated by the parties in the payment clauses remained the same throughout performance of the contracts.

Plaintiffs make much of the fact that very little transacting of business was done at the 80 to 1 rate. However, this was true, as indicated above, when plaintiffs negotiated and executed their contracts, and it was true throughout contract performance. Accordingly, it is difficult to appreciate plaintiffs' assertion that from October 1, 1967, and thereafter, the "effective legal rate" was 118 to 1. It is just as correct to say that the "effective legal rate" was 118 to 1 from 1966 and thereafter. This is made evident by an analysis of the International Monetary Fund Reports, referred to previously, which reflects the existence of the two recognized legal rates of exchange, both before and after October 1, 1967. Since an "effective legal rate" of 118 to 1 existed from 1966, it cannot be said that it suddenly changed on October 1, 1967. Moreover, it is unreasonable to assume that the payment clauses anticipated payment at the "effective legal rate" (118 to 1) because the parties clearly utilized the official rate (80 to 1) when they contracted with one another. It would be unreasonable to read the payment clauses as meaning that the dollar amount had been arrived at by applying the official rate of 80 to 1 (which was done) but that the piaster figures were to be restored during contract performance by applying the "effective legal rate" of 118 to 1 (which defendant refused to do).

Accepting plaintiff's view, arguendo, that the clauses were designed to protect the contractors against any change in the legal rate of exchange, it is clear that no changes occurred in either of the two existing legal rates of exchange during contract performance. The official rate remained at 80 to 1 and the "Consolidation Premium," which plaintiffs are wont

to describe as the "effective legal rate," remained at 118 to 1. Having contracted with defendant at the official legal rate of 80 to 1, at a time when the "effective legal rate" of 118 to 1 was also prominently in existence, no persuasive claim can be made that the "effective legal rate" of 118 to 1 should now be adopted as reflecting the intendment of the parties at the time they entered into the contracts.[13]

We have seen that a contractually contemplated change in the "legal rate of exchange" never occurred at any time material herein. What did occur, however, was that the United States Government was permitted by the South Vietnamese Government to purchase in South Vietnam, commencing on and after October 1, 1967, 118 piasters for one dollar. Plaintiffs argue, in effect, that the additional 38 piasters should be passed on through to them relative to each contract dollar generated on and after October 1, 1967. Plaintiffs offer no legal authority for the proposition that defendant was obligated to pass this subsidy along to those with whom it had dealings. As indicated above, no contractual obligation existed in this regard. As long as the official legal rate remained at 80 to 1, defendant met its contractual obligations in effecting contract payments to plaintiffs at that rate. Any alleged "windfall" to defendant is no different, in essence, than other situations where one contracting party discovers that it is able to secure contract performance at a lower cost than first anticipated. For example, *see Penker Constr. Co.* v. *United States*, 96 Ct. Cl. 1, 36 (1942); *see also Carolina Paper Mills, Inc.*, 58–1 BCA ¶1734, p. 6648. After October 1, 1967, the defendant was able to purchase piasters at the 118 to 1 rate. Absent a contractual obligation, no rule of law requires that defendant pay plaintiffs the additional 38-piaster subsidy it was able to obtain by purchase in its sovereign capacity.[14] In the domains of commerce the govern-

[13] In other contexts and circumstances use of a commercial (effective) rate of exchange rather than the official rate of exchange may well be found to be legally proper. *See e.g., Pan-American Life Ins. Co.* v. *Bianco*, 362 F. 2d 167 (5th Cir. 1966); *see also* 5 CORBIN ON CONTRACTS § 1005. In the instant cases, however, the parties by their contracts agreed to the rate of exchange that would govern their dealings with each other.

[14] The courts have long recognized a distinction between actions involving the United States in its sovereign capacity and acts it performs as a contractor. *See Horowitz* v. *United States*, 267 U.S. 458, 461 (1925); *Anthony P. Miller, Inc.* v. *United States*, 161 Ct. Cl. 455, 471–72, *cert. denied*, 375 U.S. 879 (1963).

ment and the contractor are on equal footing and subject to the same laws that govern individuals. *Cooke* v. *United States*, 91 U.S. 389, 398 (1875). Both must turn square corners in their dealings with each other. *Rock Island Etc. R.R.* v. *United States*, 254 U.S. 141, 143 (1920); *St. Regis Paper Co.* v. *United States*, 368 U.S. 208, 229 (1961). If the contracts in question were between private parties, the fact that one of the parties was able to purchase piasters at the exchange rate of 118 to 1 would not, without more, entitle the other parties to recover the additional 38 piasters from the first party merely because it was able, subsequent to entering into the contracts, to obtain a more favorable currency exchange rate. See in this regard *Barr* v. *United States*, 324 U.S. 83, 90 (1945). This is even more pronounced in these cases when it is borne in mind that the bids prepared by plaintiffs were submitted in piasters on the basis of an 80 to 1 exchange rate and plaintiffs were paid in piasters on the same basis. We agree with the Board that, under the circumstances, plaintiffs were paid all that they were entitled to receive.

Having concluded that no contractual basis, or any other basis for that matter, exists which would support recovery by plaintiffs herein, it is unnecessary to become immersed in the parties' imbroglio concerning an alleged "Secret Agreement," which defendant proffers as an alternative basis for denial of the claims,[15] or face the difficult and delicate question of reciprocity under 28 U.S.C. § 2502 presented by defendant.[16] Likewise, it will not be necessary to deal with the

[15] Defendant maintains that when the United States Government was permitted to purchase piasters at the exchange rate of 118 to 1, the United States Embassy in South Vietnam agreed with the South Vietnamese Government that the 38-piaster premium would not be passed on the South Vietnamese contractors. The Board, referring to that part of the agreement mentioned above as an "apparent hand-shake agreement," did not rely on it in reaching its determination. The basic written agreement itself was not part of the Board records since it had not been declassified as of the time the records before the Board were closed. This written agreement was subsequently declassified and available. The decision herein is not based on or affected in any way by the so-called "Secret Agreement."

[16] By Order dated June 15, 1973, the Court denied defendant's motion to dismiss the petitions on the reciprocity question, remanding the matter to the trial judge for further proceedings. The record, wholly documentary, now before the court on the reciprocity question is still considered insufficient to

(Continued)

legal effect of releases executed by seven of the ten plaintiffs,[17] nor will it be necessary to dwell on the myriad other matters to which the parties have directed the court's attention.[18]

Although the extensive briefs of the parties belie the fact, the issue presented to the court is admittedly simply one of contract interpretation. The disputed language in the payment clauses, when read in the light of the circumstances, known to all parties, existing at the time of contract formation and execution can only be read to mean that defendant would make payments in Vietnamese piasters at the official rate of exchange in effect on the date approved invoices were presented for payment. At all times pertinent herein, that official rate, which has been determined herein to be the legal rate contemplated by the parties, was 80 to 1. Accordingly, defendant has fully met its obligations under the contracts.

## CONCLUSION

For reasons set forth above, defendant's motion for summary judgment is granted, plaintiffs' cross-motion for summary judgment denied and plaintiffs' petitions dismissed.

---

(Continued)
permit of an enlightened decision thereon. Moreover, the question is complicated by the fall of the Republic of South Vietnam on or about April 30, 1975. With the fall of the Republic of South Vietnam, Foreign Assets Control Regulations were amended on May 1, 1975, to add South Vietnam to the schedule of blocked countries. *See* 40 Fed. Reg. 19202, 31 C.F.R. § 500. The disposition of these litigations on other grounds pretermits this and related troublesome questions.

[17] Three plaintiffs (Ct. Cl. Nos. 456–72, 457–72, 463–72) did not execute releases and are therefore beyond the pale of defendant's release defense. The seven plaintiffs who signed releases challenge not only the legal sufficiency of the releases themselves but also the legal efficacy of their actions under the circumstances which existed when they executed them, *i.e.*, defendant improperly induced plaintiffs to sign the releases and/or improperly refused subsequently to allow plaintiffs to renounce these executions. No decision is reached on the release defense offered by defendant. *See Jefferson Constr. Co.* v. *United States*, 151 Ct. Cl. 75, 91–92 (1960).

[18] For example, the parties unnecessarily debate the fifth amendment rights of resident and nonresident aliens. Further, plaintiffs' reliance on quantum meruit as an alternative legal theory for recovery overlooks the principle that there can be no recovery on this theory where there are valid express contracts between the parties. *National Trailer Convoy, Inc.* v. *United States*, 170 Ct. Cl. 823, 827–28, 345 F. 2d 573, 576 (1965). Plaintiffs also allude in their moving brief to fraud on the part of various government officials relative to proceedings before the Board and thereafter. The argumentative allegations in their brief in this regard are devoid of substance. "Well-nigh irrefragable proof" is necessary to support fraud charges directed at government officials. *Knotts* v. *United States*, 128 Ct. Cl. 489, 492, 121 F. Supp. 630, 631 (1954); *see also Librach and Cutler* v. *United States*, 147 Ct. Cl. 605, 612 (1959).

Syllabus

# JOHN B. LAMBERT & ASSOCIATES—CLEVELAND AGENCY, INC. AND JOHN B. LAMBERT & ASSOCIATES—NORTHEASTERN OHIO AGENCY, INC. v. THE UNITED STATES

[No. 151–73. Decided November 17, 1976]

ON THE PROOFS

**Taxes; income tax; accumulated earnings tax; reasonable business need; failure to raise administratively claim re "pre-notice" interest assessment.**—This is a suit for refund of assessed and paid accumulated earnings taxes, plus interest, for years 1967 and 1968 re John B. Lambert & Associates—Northeastern Ohio Agency, Inc., and 1968 re John B. Lambert & Associates—Cleveland Agency, Inc. During the tax years in issue Mr. and Mrs. Lambert each owned a half interest in the corporations, constituting all of the shareholders. Plaintiffs contend that the taxes were erroneously assessed because the earnings were earmarked for the reasonable needs of their business, i.e. the intended redemption of Mrs. Lambert's 50% interest in the corporations. It is *held* that the surtax was properly imposed because the redemption satisfied only a personal aim of Mrs. Lambert rather than a reasonable business need of the corporate taxpayers; that the proof offered failed to overcome, by the required preponderance of evidence, the statutory presumption of Sec. 533 of the Internal Revenue Code of 1954 that earnings and profits, when accumulated beyond the reasonable needs of the business shall be determinative of the purpose to avoid income tax with respect to shareholders; and that the deficiency interest, assessed and paid for the period from the due date of the respective corporate tax returns to the later date of notice and demand by the Government is not recoverable because this issue was not raised administratively, even though the interest was erroneously assessed for said period. Plaintiffs are not entitled to recover and the petition is dismissed.

**Taxes; income tax; accumulated earnings tax; generally.**

[1] The purpose of the accumulated earnings tax is to discourage the use of a corporate entity as the means of avoiding personal income tax of shareholders through nondistribution of earnings and profits.

Internal Revenue ⇐ 763.1

**Taxes; income tax; accumulated earnings tax; reasonable needs of the business.**

[2] Under certain circumstances, for example, to promote corporate harmony, efficiency of management or to enable a corporation to continue its accustomed practice or policies, an accumulation of earnings to fund a stock redemption may constitute an accumulation for a "reasonable need of the business" within the meaning of Secs. 535(c) and 537 of the Internal Revenue Code of 1954.

Internal Revenue ⇐ 763.2

Syllabus

**Taxes; income tax; accumulated earnings tax; reasonable needs of the business.**

[3] Where the involvement of the wife-shareholder in corporate business matters was only occasional, her unwillingness to remain committed to the expansion ambitions of her co-shareholder husband did not impede the profitability of business operations, her disagreements with management never rose to the point of obstruction, final managerial decisions rested with the husband, and after redemption of her 50% interest in the corporation the business was conducted on the same basis as theretofore, the accumulations of earnings and profits to fund redemption of her shares fulfilled no reasonable business need of the corporation; the redemption redounded only to the wife's personal benefit permitting her to receive capital gain treatment for corporate distributions which had theretofore been minimal and which, but for the unreasonable accumulation, would have been distributed and subject to taxation at ordinary income rates.

Internal Revenue ⇐ 763.2

**Taxes; income tax; accumulated earnings tax; reasonable needs of business; burden of proof.**

[4] In order for a taxpayer to overcome the presumption of Sec. 533 of the Code of a tax avoidance purpose in accumulating earnings and profits beyond the reasonable needs of its business, it must establish by the preponderance of the evidence that tax avoidance with respect to shareholders was not *one* of the purposes for said accumulation.

Internal Revenue ⇐ 2129

**Taxes; income tax; accumulated earnings tax; reasonable needs of business; burden of proof.**

[5] Where there is an accumulation of earnings and profits beyond the reasonable needs of the business, actual knowledge of the favorable tax consequences to the corporation's shareholders, and lack of evidence to suggest that the redemption of shareholders' stock would have taken place even if the accumulations for that purpose had held out no possibility of tax savings to the shareholders, the presumption of Sec. 533 has not been overcome.

Internal Revenue ⇐ 2129

**Taxes; interest; interest on underpayments; accumulated earnings tax; date when interest accrues.**

[6] Interest with respect to a deficiency assessed on account of the accumulated earnings tax begins to run only after notice and demand by the Government and not from any earlier time. *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 420 F. 2d 702 (1970).

Internal Revenue ⇐ 1747

**Taxes; civil actions for refund of taxes; claim for refund, administrative; necessity for filing; accumulated earnings tax.**

[7] A ground for tax refund neither specifically raised by, nor comprised within the general language of, a timely formal or informal

Opinion of Trial Judge

application for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated. Thus, where taxpayers did not administratively raise the independent "pre-notice" interest issue, they are precluded from recovery thereon and cannot rely on their general claims for refund of the taxes and interest which were tied entirely to the lawfulness of the principal tax, even though the interest was erroneously assessed from the due date of their respective corporate income tax returns rather than from the date that the Government first gave notice and demand for the taxes.

Internal Revenue ⇐ 2028

*Stephen C. Ellis*, attorney of record, for plaintiffs. *Arter & Hadden*, of counsel.

*Charles E. Auslander, Jr.*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

---

Before SKELTON, NICHOLS and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed July 19, 1976, pursuant to Rule 141(b) moving that the court adopt the recommended decision of Trial Judge John P. Wiese, filed June 9, 1976, pursuant to Rule 134(h), as the basis for its judgment in this case since plaintiffs have filed no notice of intention to except thereto and the time for so filing pursuant to the Rules of the court has expired. Upon consideration thereof, without oral argument, since the court agrees with the said recommended decision, as hereinafter set forth,* it hereby affirms and adopts the same as the basis for its judgment in this case. Therefore, defendant's motion of July 19, 1976, is granted,

WIESE, *Trial Judge:* The corporate plaintiffs involved in this tax refund suit were assessed the surtax that is imposed

OPINION OF TRIAL JUDGE

WIESE, *Trial Judge:* The corporate plaintiffs involved in this tax refund suit were assessed the surtax that is imposed

*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed June 9, 1976, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

by Sections 531–32 of the Internal Revenue Code of 1954[1] on every corporation "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders * * * by permitting earnings and profits to accumulate instead of being divided or distributed." After payment of the tax (together with interest measured from the return due date for the particular years involved), timely administrative claims for refund were filed. These asserted that the earnings against which the tax had been imposed represented accumulations earmarked for a reasonable business need, to wit: the intended redemption of the shares of a stockholder who held a 50 percent interest in each of the two corporations. The Commissioner of Internal Revenue rejected the refunds on the basis claimed. We do also. Specifically, the conclusions reached here are: (*i*) the redemption in question satisfied only a personal aim of the shareholder rather than a reasonable business need of the plaintiffs; (ii) the proof offered failed to overcome, by the required preponderance of evidence, the statutory presumption of Section 533(a) that earnings and profits, when accumulated beyond the reasonable needs of the business, the case here, "shall be determinative of the purpose" to avoid income tax with respect to shareholders; and (iii) the deficiency interest, paid for the period extending from the due date of the corporate tax returns to the later date of notice and demand by the Government, is not recoverable for failure to raise this issue in the administrative claims for refund.

## *I. Facts***

Plaintiffs, John B. Lambert and Associates—Cleveland Agency, Inc. (hereinafter the Cleveland Agency or taxpayer) and John B. Lambert and Associates—Northeastern Ohio Agency, Inc. (hereinafter the Northeastern Agency or taxpayer), are Ohio corporations actively engaged in the business of selling and servicing health, accident, life and similar

[1] Unless otherwise indicated, all code section references in this opinion are to the Internal Revenue Code of 1954, as amended and in effect in the years in issue.

**The facts recited in this opinion restate the separate Finding of Fact only to the extent necessary to an understanding of the result.

forms of insurance. John B. Lambert is president and chief executive officer of both corporations; he has served in this capacity continuously since the establishment of the corporations in 1959. Margaret M. Lambert is John B. Lambert's wife; she was employed as the vice-president of the Cleveland Agency from the time of incorporation until 1967. During the tax years in issue in this case, 1967–68, Mr. and Mrs. Lambert each owned a half interest in the plaintiff corporations and, consequently, together they constituted all of the plaintiffs' shareholders.

The insurance business of the plaintiff corporations began as a partnership between the Lamberts in Tucson, Arizona in 1932. In 1935, the partnership moved to Phoenix, Arizona, and then, in 1945, the business relocated once again, this time to Cleveland, Ohio. On January 2, 1960, the partnership was divided. The insurance business then being conducted in the Cleveland area was taken over by the plaintiff, Cleveland Agency, a corporation then newly organized for that purpose; the business in the outlying areas was absorbed by the plaintiff, Northeastern Agency, likewise a then newly organized corporation.

In the five-year period immediately following the move to Cleveland (1945–50), the business experienced its greatest growth. During this time, it expanded its territory to include 14 contiguous counties in Northeast Ohio, it opened seven separate offices, and, at one point in this period, employed as many as 127 sales personnel. Following incorporation in 1959 and until approximately 1969, the business stabilized. No new offices were added, the sales staff was reduced to approximately 100 salesmen, and, through 1967, only two offers were made to acquire other agencies, neither of which proved successful. After 1969, the business declined to some degree.

During the period of rapid growth (1945–50), expansion was financed entirely from profits derived from the business. Debt financing was never required. In fact, at no point during the entire partnership period, nor even during the later years of incorporation preceding the redemption of Margaret Lambert's shares in December 1969, did the business ever incur any long-term debt. All business objectives, growth included, were pursued on a cash only basis—a managerial

policy that reflected the fiscal conservatism of the chief executive, John Lambert.

During the years of partnership, the profits derived from the business were shared equally between the Lamberts. Over this same period, however, Mrs. Lambert's role in the business was one of gradually lessening participation. Initially, that is, while the business was still located in Tucson, Arizona, her responsibilities included office administration and bookkeeping and Mr. Lambert was responsible for insurance sales and service. However, with the growth of the business administrative personnel were added and Mrs. Lambert's functions became more supervisory in nature requiring less, on her part, in the way of involvement in the everyday affairs of the business. Additionally, with the developing success of the business, commitment to the raising of her family and the pursuit of other nonbusiness interests became matters of greater concern to Mrs. Lambert. Thus, by the time incorporation was decided upon in 1959, Mrs. Lambert was no longer routinely involved in everyday partnership matters but she did, however, continue to involve herself in discussions bearing upon matters of major importance to the business.

The gradual withdrawal of Mrs. Lambert from the concerns of a daily business routine was accompanied also by a gradually changing attitude on her part towards continued growth of the business. Whereas Mr. Lambert retained a commitment to expansion well beyond the time of initial incorporation, Mrs. Lambert, on the other hand, had long since felt much the other way. Beginning in the late 1940's, she had begun to question, on a personal level, the need for, as well as the wisdom of, further growth. By stages, this questioning of the continuing pursuit of further growth intensified to the point of disenchantment with the business in general so that, by 1959, she no longer wanted to be involved with the business to any degree. Finally, in 1967, her desire to be free of concern and to have time and money for travel led her to request the redemption of her shares in the two corporations.

The request for redemption was informally acceded to by the corporations and, by way of implementation of this goal,

a request for ruling was submitted to the Internal Revenue Service. Simultaneously, but again on an informal basis, it was decided that the redemption would be carried out either upon the receipt of a favorable ruling from the Internal Revenue Service or upon the expiration of 10 years from the date of initial incorporation, whichever might first occur.[2]

The requested ruling did not materialize and on December 29, 1969—10 years after the date of initial incorporation—the parties executed redemption agreements which provided that Mrs. Lambert would receive $130,000 for her stock in the Cleveland Agency and $177,000 for her stock in the Northeastern Agency. Payment, in each case, was to be accomplished through six annual installments subject to interest of 4 percent on all unpaid balances.

Throughout their existence, Mr. Lambert was the principal decision maker with regard to determining corporate cash management policies. By virtue of their adherence to his business philosophy, the corporations sought to maintain a strong cash position, and, in keeping with this, historically paid small dividends, never exceeding $250 per year per corporation. Consequently, in the three-year period immediately preceding execution of the redemption agreements in 1969, there were no distributions of earnings and profits except for the indicated minimum dividend of $250. During this same period plaintiffs had net income, after payment of federal taxes, in the following amounts:

| | *Northeastern Agency* | *Cleveland Agency* |
|---|---|---|
| 1966 | $12, 186. 44 | $14, 930. 70 |
| 1967 | $19, 407. 41 | $21, 144. 88 |
| 1968 | $16, 639. 92 | $12, 440. 56 |

In addition to their retention of the net earnings listed above, the plaintiffs' prior year accumulations, as reflected

[2] The 10-year cut-off period was deemed to be significant in this situation because counsel (not the present counsel of record) had previously advised that, after this period, the parties could safely proceed with regard to the issue for which the tax ruling had been sought, namely, the certainty that any gain realized by Mrs. Lambert upon the redemption of her shares would then qualify as long-term capital gain.

in net liquid assets (meaning current assets less current liabilities [3]) were in the following amounts:

| | *Northeastern Agency* | *Cleveland Agency* |
|---|---|---|
| 1966 | $94, 366. 38 | $105. 582. 86 |
| 1967 | $115, 071. 95 | $128, 341. 27 |
| 1968 | $154, 057. 20 | $142, 958. 68 |

On audit of the Cleveland Agency's federal income tax return for the year 1968, and of the Northeastern Agency's returns for the years 1967 and 1968, the Commissioner of Internal Revenue assessed an accumulated earnings tax. As noted, the basis for refund of the tax (and the interest that was paid therewith) is the contention that there existed a reasonable business need to accumulate earnings and profits, namely, payment for the redemption of the shares of a 50 percent stockholder.

## *II. Discussion*

A. The purpose of the accumulated earnings tax is to discourage the use of a corporate entity as the means of avoiding personal income tax of shareholders through nondistribution of earnings and profits. The aim of the tax "is to compel the company to distribute any profits not needed for the conduct of its business so that, when so distributed, individual stockholders will become liable" for taxes on the dividends received. *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 699 (1943). Accordingly, the tax is imposed upon any corporation (other than a personal holding company or a corporation exempt from federal income tax [4]) which is formed or availed of for the purpose of avoiding the income tax with respect to its shareholders by permitting earnings and profits to accumulate instead of being distributed. Section 532. If a corporation accumulates earnings and profits in excess of

[3] As used here, "current assets" include the balance sheet items of cash, accounts receivable, other current assets and investments in corporate securities; excluded are investments in buildings, land and other business-related assets such as the cash surrender value of insurance policies. "Current liabilities" here include all liabilities except capital stock and retained earnings. The corporations had no long-term debts.

[4] Section 532(b) exempts personal holding companies, foreign personal holding companies, and certain tax-exempt corporations. Both types of holding companies are taxed under other provisions of the code. *See* Internal Revenue Code of 1954, §§ 541–47 (personal holding companies); Internal Revenue Code of 1954, §§ 551–58 (foreign personal holding companies).

its reasonable business needs, the forbidden purpose is presumed to be present unless the corporation proves otherwise by a preponderance of the evidence. Section 533.

In determining accumulated taxable income for any year,[5] Section 535 allows as a deduction from taxable income, *inter alia*, an accumulated earnings credit for that portion of the earnings and profits retained for the reasonable needs of the business, with a minimum allowable accumulation over the life of the corporation of $100,000. Moreover, Section 537 provides that reasonable needs of the business include "reasonably anticipated needs."

Thus, there will be no accumulated earnings tax on a corporation to the extent that it can show that an accumulation was for the reasonable needs of its business (present or anticipated), and, in all events, there will be no such tax on an accumulation which, when added to the lifetime accumulation, does not exceed $100,000.

The statutory considerations identified above define the threshold issue in this case: whether the retention of earnings and profits during the years in issue represented accumulations required for reasonable needs of the business. By way of answer, we begin with the point on which the parties agree, namely, that under certain circumstances, for example, to promote corporate harmony, efficiency of management or to enable a corporation to continue its accustomed practices or policies, an accumulation of earnings to fund a stock redemption may constitute an accumulation for a "reasonable need of the business" within the meaning of Sections 535(c) and 537. This much is not debated. Where the parties do part company, however, is on the factual side of this case, specifically, whether the circumstances present here justify the argument that the redemption of Mrs. Lambert's shares served a reasonable business need.

To put this issue into proper focus, it is essential to note that, in the cases which have upheld a corporation's decision to redeem a shareholder's interest on grounds of reasonable business need, the dispositive factual consideration was

[5] The tax is imposed for each taxable year at a rate of 27½ percent on the first $100,000 of accumulated taxable income (defined in Section 535) and 38½ percent on accumulated taxable income in excess of $100,000. Section 531.

always the existence of competing demands among shareholders of a sort that imperiled the very existence of the corporation or, at least, the manner in which up to then it had been successfully conducting its business affairs.

An example is *Mountain State Steel Foundries, Inc.* v. *Commissioner*, 284 F. 2d 737 (4th Cir. 1960), a case in which it was held that the application of present and future earnings and profits for the redemption of 50 percent of the corporation's stock served a reasonable business need (rather than as a vehicle for dividend avoidance) in light of the fact that the two families owning all the stock had antagonistic interests which, if left unresolved, would have resulted in the corporation's liquidation.

The corporation had been owned equally by Ben Miller and Harold Stratton. Upon the death of Ben Miller, his widow and children inherited his stock. The Millers, who took no active part in the conduct of the business, became unhappy with the uncertain prospect of dividend payments, while the Strattons, who were active in the business and already deriving income from it through salaries, were interested in expanding and improving the business. This conflict of interest between the stockholders led Mrs. Miller to demand that the business be sold. An attempt was made to find a purchaser for all of the stock or the corporate assets. This proved unsuccessful. It was then proposed by Mrs. Miller that the corporation buy her stock with payments to be made over a period of years. This was agreed to. Regarding the decision to redeem the Miller's interest, the court stated:

> When the stockholders have such conflicting interests, the corporation and its future are necessarily affected. When the situation results in demands that the business be sold or liquidated, as it did here, the impact of the conflict upon the corporation is direct and immediate. * * * The resolution of such a conflict, so that the need of the corporation may govern managerial decision, is plainly a corporate purpose. [*Mountain State Steel Foundries, Inc.* v. *United States*, *supra*, 284 F. 2d at 745.]

The outcome that was reached in *Mountain State* had its counterpart in the earlier decision of *Dill Manufacturing Co.*

v. *Commissioner*, 39 B.T.A. 1023 (1939). There, as in *Mountain State*, dissatisfaction with the dividends generated by the business led the owners of a minority interest in the corporation (a 49.98 percent interest) to demand the sale of the business or else its merger with a larger concern. To overcome this dissension, it was determined that the minority stock interests would be redeemed through what amounted to a partial liquidation carried out over a five-year period. The Commissioner challenged the redemption on the grounds that it represented a diversion of earnings that had been planned from the outset of the corporation. The challenge failed for lack of proof;[6] the court went on to say:

> * * * The petitioner [the corporate plaintiff] constituted the life work of its operating officers. They had built it and were proud of it. The protection of the economic and financial independence of that work was scarcely less warranted as a business purpose than if petitioner had been an individual. [39 B.T.A. at 1033.]

The concept of protective redemption presented by the facts in *Mountain State* and *Dill Manufacturing* is repeated in other decisions as well. Among these are: *Fred F. Fischer*, 6 CCH Tax Ct. Mem. 520 (1947), where the redemption became necessary in order to head off receivership proceedings threatened by a minority shareholder; *Farmers & Merchants Investment Co.*, 29 CCH Tax Ct. Mem. 705 (1970), and *Penn Needle Art Co.*, 17 CCH Tax Ct. Mem. 504 (1958), where redemptions were triggered by an unexpected, but serious rupture in the long-standing relationship between the owner-managers of the businesses involved and the consequent demand that the interests of one or the other be bought out, and, finally, *Gazette Publishing Co.* v. *Self*, 103 F. Supp. 779 (E.D. Ark. 1952), where again unexpected discord precipitated the corporation's need to apply an existing accumulation (earlier earmarked for other business needs) to redeem the shares of an owner-manager (a 21.15 percent interest and the largest single stockholder) in order to prevent that interest from being acquired by outsiders whose endeavor might

[6] In *Dill Manufacturing Co.* v. *Commissioner*, 39 B.T.A. 1023 (1939), the Commissioner had made no determination of an accumulated earnings tax deficiency until the filing of an amended answer in the Tax Court; hence the burden of proof as to that issue was on the Government.

then be to change the corporation's editorial and management policies.

Mindful of the import of these several decisions, plaintiffs now make the argument that similar considerations of business necessity dictated the redemption of Mrs. Lambert's shares. The plaintiffs' business, it is claimed, demanded active participation in day-to-day affairs on the part of the major owners. In addition, because they were closely held corporations, it is said too that the plaintiffs required a highly active shareholder-management force committed to similar management goals. The argument is that these requirements, when assessed in light of the disparity between the Lamberts with regard to their respective levels of participation in day-to-day corporate affairs and the differences between them concerning business goals and objectives, dictated the need for redemption in order to eliminate claimed immediate and potential future disharmony.

As said, the Government for its part does not question the premise that redemptions undertaken to insure corporate survival or to head-off paralyzing disunity serve a reasonable business need. Rather, what the Government attacks is the factual basis for the taxpayer's argument—the contention that Mrs. Lambert's position as owner represented a source of immediate as well as future dissension sufficient to warrant her purchased withdrawal. The Government flatly says that there was never a threat to liquidate taxpayers as a result of shareholder differences nor was there any plausible basis upon which to speculate concerning future discord.

The Government's challenge on the facts is well taken. The evidence, rather than supporting the argument made, cuts the other way. First, as to the contention that the corporations required an owner-manager force that would devote itself fully to everyday business affairs, the facts show otherwise. During the partnership years, Mrs. Lambert's participation in daily business matters had been gradually lessening so that by 1959, the year of incorporation, her involvement with the concerns of daily business matters was by then, at best, occasional. Thus, the corporations never had the benefit of her daily involvement, and given, nevertheless, their profitability in the years that followed incorporation, it can hardly be

claimed now that business success demanded equal participation on the part of the owners.

As to the second contention, namely, that the corporations needed a shareholder-management force committed to common business goals, here, again, history demonstrates otherwise. Mrs. Lambert's disenchantment with the business and her unwillingness to remain committed to the expansion-oriented ambitions of her husband were attitudes which had firmly crystallized by 1959. But, again, neither of these "anti-business" attitudes impeded the profitability of the business operations in the post-1959 period. Indeed, it is significant to note that offers to expand the business through the purchase of other insurance agencies were tendered as late as 1967—the very year in which Mrs. Lambert's stock redemption was informally agreed upon.

It is true, of course, that after 1959, the operations, though continuing to be profitable, did not continue to grow. However, there is nothing in the record to suggest that stability, rather than continued growth, was the consequence of Mrs. Lambert's retreat from active participation and wholehearted commitment to the business. During this period, the business functioned as it had always before—final decisions on all important matters rested with Mr. Lambert. And those decisions, while perhaps not always warmly endorsed by Mrs. Lambert, were nevertheless always adopted by her. Her disagreements, such as they were, never rose to the point of obstruction.

On the basis of these facts—the on-going profitability of the business enterprise in the years following incorporation coupled with the essentially passive role played by Mrs. Lambert during this same time frame—it cannot be claimed that her role in the business was such as to warrant its identification with the success and direction of the business either in the past or for the future. Because Mrs. Lambert played only a minimal, nonassertive, role in the business life of the corporations, the redemption of her shares really gained the corporations nothing. In point of fact, after the redemption business was conducted on the same basis as it had been conducted before the redemption. Mr. Lambert continued to consult with Mrs. Lambert (though perhaps not with the

same degree of frequency) and, just as before, final decisions rested ultimately with Mr. Lambert. In short, the business purpose ascribed to the redemption was nonexistent; the redemption redounded only to the personal benefit of Mrs. Lambert for it permitted her to receive capital gain treatment for distributions that would otherwise have came to her as dividends subject to taxation at ordinary income rates. It follows, therefore, that the accumulations of earnings and profits to satisfy the redemption obligations fulfilled no reasonable business need of the corporate taxpayers.

B. When earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, then Section 533 declares that this shall be determinative of the purpose to avoid the tax "unless the corporation by the preponderance of the evidence shall prove to the contrary." This section, in addition to creating a statutory presumption of an avoidance purpose also provides a taxpayer with what was described by Justice Harlan in his separate opinion in *United States* v. *Donruss Co.*, 393 U.S. 297, 310 (1969), as a "last clear chance" to show that, the unreasonableness of the accumulation notwithstanding, it was nevertheless not inspired by tax avoidance considerations. But, to prevail, the taxpayers must establish by the preponderance of the evidence that tax avoidance with respect to shareholders was not *one* of the purposes for the accumulation beyond the reasonable needs of the business. *United States* v. *Donruss Co.*, *supra.* That required showing has not been made here and the presumption therefore controls the outcome.

An extended analysis justifying the decision against the taxpayers is not required. The accumulations of earnings that were brought into issue in this case were sought to be justified on only one business ground, that being, the decision to redeem Mrs. Lambert's shares. The rejection of that ground as a legitimate business need, together with the absence here of any other comparatively objective criteria that might explain the accumulations from a business-need standpoint, directs the focus for determining intent (meaning, the actual purpose for the accumulations) to considerations personal to the shareholders. And that does not offer enough to win, at least not this case.

The record bares the fact that Mr. Lambert was well aware of the undesirable effect that a distribution of earnings and profits would have upon the Lamberts' personal income tax.[7] Indeed, one could go so far as to say that awareness of these tax consequences actually contributed to the decision to accumulate for it was admitted that tax ramifications were "considered" in setting dividend policy. However, taking this admission only in its narrowest sense, that is, that there was knowledge of the tax consequences without any attendant purpose to avoid taxes, still, this fact, when joined with the lack of any acceptable business reason for the accumulation of earnings and profits, leaves the proof wanting. Simply put, the presumption of Section 533 has not been overcome.

This is not to say that a purpose to avoid the tax with respect to shareholders may be implied in every case where knowledge of the tax consequences of an accumulation has been shown to exist. Clearly, that is not the law. *United States* v. *Donruss Co.*, *supra*, 393 U.S. at 309. Rather, the point intended is an evidentiary one: the presumption of a tax avoidance purpose that arises under Section 533 on the basis of a finding of an unreasonable accumulation is a formidable one to overcome; and, when further buttressed by proof of actual knowledge of the favorable tax consequences to the shareholders of such accumulations, it becomes imperative that the proof demonstrate reasonably definite grounds from which to infer the existence of a contrary purpose. Here no business needs were offered as reasons for the accumulations in issue save the intended redemptions and, as to these last, there is nothing to suggest that the redemptions would have taken place even if the accumulations for that purpose had held out no possibility of tax savings to the shareholders. The combination of an accumulation beyond the reasonable needs of the business joined with a corresponding tax advantage to the corporation's shareholders "is evidence enough to uphold

[7] In 1967, had the Northeastern Agency paid dividends equal in amount to its net after tax income of $19,157.41 (in lieu of the $250 dividend that was paid), the Lamberts' own federal tax liability would have been increased by $11,290.33. Similarly, in 1968, had the taxpayers each paid dividends equal to the total of their net after tax income of $28,575.48 (in lieu of the $250 which each did pay), the Lamberts' own federal tax liability would have been increased by $20,715.96.

the taxes in question." *Trico Products Corp.* v. *McGowan*, 67 F. Supp. 311, 325 (W.D.N.Y. 1946).

C. A final matter that needs to be addressed concerns the question of interest. The taxpayers were assessed interest on their accumulated earnings taxes measured from the due date of their respective corporate income tax returns rather than from the date that the Government first gave notice and demand for the taxes. The collection of this "pre-notice" interest was contrary to the decision in *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 420 F. 2d 702 (1970), the case in which this court held that interest with respect to a deficiency assessed on account of the accumulated earnings tax begins to run only after notice and demand by the Government and not from any earlier time.

The Government concedes that there was an erroneous assessment of interest. However, it denies that plaintiffs are entitled to any recovery on account of it. The denial rests on the contention that plaintiffs failed to raise the interest issue in their administrative refund claims; additionally, they failed to raise it in this court either in their petition, their pretrial submissions, or in their opening brief.[8]

The Government's position must be upheld. "It is an undisputed general rule that a ground for refund neither specifically raised by, nor comprised within the general language of, a timely formal or informal application for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated." *Union Pacific R.R.* v. *United States*, 182 Ct. Cl. 103, 108, 389 F. 2d 437, 442 (1968). Even where deficiency interest alone is at stake, timely notice at the administrative level is a prerequisite to later suit. *Alexander Proudfoot Co.* v. *United States*, 197 Ct. Cl. 219, 454 F. 2d 1379 (1972). Such notice was not given here.

In the administrative refund claims which the taxpayers filed in this case, it was stated that the amount of the accumulated earnings tax that had been paid "together with interest * * * was erroneously assessed and collected." Given as the reason for the alleged erroneous assessment was that the "[t]axpayer had definitely committed itself to a proposed

[8] The issue did not surface until it was raised by the Government in its brief.

purchase of its shares from a shareholder and had earmarked the allegedly accumulated funds for such purpose." [9] The refunds sought were for the entire amount assessed in each year. Thus, in reality, the taxpayers had limited their claims for refund to the validity of the underlying tax, and interest, to the extent that it was also being contested, was tied entirely to the lawfulness of the principal tax. An independent claim for "pre-notice" interest was clearly not presented. And, on the basis of what was said in the refund claims, it would be inappropriate to infer notice of such a claim now. Moreover, the fact that plaintiffs filed claims for refund sufficient in amount to encompass the lesser amounts that a recovery of pre-notice interest would entail is of no legal consequence for "[n]umbers alone * * * cannot satisfy the rule that a claim for refund must set out the grounds upon which it rests." *Estate of McCabe* v. *United States*, 201 Ct. Cl. 243, 246, 475 F. 2d 1142, 1144 (1973).

On this same subject, and for the sake of fully addressing the matter of notice, there is one last point that merits comment. In the rejection of the plaintiffs' refund claims, the Internal Revenue Service responded by saying that, "[r]epayment of interest assessed has been disallowed on the basis of *Bardahl Corp.* decision made by the U.S. District Court, West District, Washington, #7899 dated 11-10-69." This stated reason for disallowance—which was addressed to the whole amount claimed—would appear to have had nothing at all to do with the grounds upon which the refunds had been sought. More than that, however, the point we note is that the *Bardahl* decision that was referred to by the Internal Revenue Service (*Bardahl Mfg. Corp.* v. *United States*, P-H 1970 FED. TAX SERV. (25 Am. Fed. Tax R. 2d 70-429) ¶70-338 (W.D. Wash., Nov. 10, 1969)) [10] was exclusively concerned with the same issue which this court dealt with (and decided otherwise) in *Motor Fuel Carriers, Inc.* v. *United States*, *supra*, namely, the starting date for the assessment of interest in connection with an accumulated earnings tax deficiency. Thus, the reference to the *Bardahl* decision, albeit

[9] There were three refund claims submitted, one for each of the years in issue. Except for differences in the amounts involved, their wording was identical.

[10] [Subsequently, this decision was *reversed*, 452 F. 2d 604 (9th Cir. 1971).]

perhaps an erroneous reference in the sense that it did not relate to the matters raised in the refund claims, might nevertheless lend support to the position that the Internal Revenue Service had construed the refund claims as including a challenge to the legality of assessing interest from the due date of the corporate returns, hence, had notice of a claim in this regard. Particularly would this be so in view of the fact that the administrative action was apparently taken after this court's contrary decision in *Motor Fuel Carriers* had been handed down.

The foregoing point has not, however, been raised by the plaintiffs in this litigation in support of their belated interest argument. In view of this, and in view also of the ambiguities inherent in the administrative action (as noted, the Internal Revenue Service rejected the entirety of the refund claims on the authority of the *Bardahl* decision even though the pre-notice interest dealt with in that case logically comprised only a small portion of plaintiffs' claims), it would be unwise for the court to now favor plaintiffs by constructing a notice argument in their behalf from facts that neither party has addressed. Plaintiffs are, therefore, not entitled to recover any part of the interest that was paid. Nor are they otherwise entitled to any recovery. The assessments against them were correct.

CONCLUSION OF LAW

Upon the trial judge's findings and opinion, which are adopted by the court, the court concludes as a matter of law that plaintiffs are not entitled to recover and the petition is dismissed.

---

545 F. 2d 1283

## COMPREHENSIVE DESIGNERS, INC. AND COMPREHENSIVE DESIGNERS INTERNATIONAL LIMITED, A CONSOLIDATED GROUP v. THE UNITED STATES

[No. 632–71. Decided December 15, 1976]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Renegotiation of contracts; redetermination of excessive profits; subcontracts.**—This case is before the court on the parties' stipula-

Syllabus

tion. Plaintiff, a consolidated group, entered into contracts with defense contractors (primarily Lockheed Aircraft Corp.) to recruit additional engineering and technical personnel for temporary periods and to perform office supply services. Plaintiffs received payments from Lockheed covering salaries, taxes and fringe benefits of said temporary employees, plus a profit, and one of the group also rented office space and rented or purchased office supplies and engineering equipment for Lockheed, receiving fees covering its expenses, plus a profit. Plaintiffs carried the employees on their payrolls and performed all tax and fringe-benefit accounting; Lockheed controlled said employees' working hours, activities, vacations, commingled them with their permanent staff, and retained the right to terminate any or all of them without cause. The Renegotiation Board determined that plaintiffs realized excessive profits during their fiscal year 1967 on these contracts. It is *held*, for the reasons given, that plaintiffs' contracts are "subcontracts" within the meaning of Sec. 103(g) of the Renegotiation Act of 1951, as amended, and implementing regulations. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted, and it is concluded that plaintiffs realized excessive profits of $1,515,000 for 1967, less appropriate federal and state tax credits. The net amount owed defendant bears interest as stipulated.

**Renegotiation of contracts; Renegotiation Act; purpose of act.**

[1] In enacting the renegotiation statute, Congress wished to deflate, retroactively, any Government-paid prices (and therefore profits) which were abnormally high due to lack of adequate price competition in wartime conditions.

War and National Defense ⇐ 59

**Renegotiation of contracts; redetermination of excessive profits; subcontracts.**

[2] Where plaintiffs contracted to supply temporary employees to contractor L for performance of defense-related projects and received payments from L covering salaries, taxes and fringe benefits of the employees, plus a profit, such contracts are subcontracts within the meaning of Sec. 103(g) of the Renegotiation Act, although L controlled the employee's working hours and activities, approved their vacations, commingled them with its permanent staff and retained the right to terminate any or all of them without cause. This comports with the legislative aim to eliminate war profiteering by those who contribute to creating abnormally high prices for the Government in the course of making products for it.

War and National Defense ⇐ 59

**Renegotiation of contracts; redetermination of excessive profits; subcontracts.**

[3] The exclusion in Sec. 103(g)(1) of the Renegotiation Act of agreements to furnish office supplies from the definition of "subcontract," reflects the thought that the sale or rental of standard

off-the-shelf items at commercial rates is not likely to give rise to excessive profits. Where plaintiffs contracted to rent office space and to rent or purchase engineering equipment for a defense contractor for a profit apart from the acquisition costs, such agreement is outside the exclusion since such services may tend to create abnormally high prices for the Government and realization of excessive profits.

War and National Defense ⟸ 59

**Renegotiation of contracts; redetermination of excessive profits; subcontracts.**

[4] Whether or not a contractor's services are integrally related to a prime defense contractor's end product within the meaning of 32 C.F.R. § 1452.4(b)(1)(v) (1967) is judgmental, and the result is controlled by economic considerations such as whether the contractor's services contributed to the creation of higher prices for the Government.

War and National Defense ⟸ 59

**Pleading and practice; defense; failure to brief or argue.**

[5] Where neither party has briefed or orally argued plaintiffs' eligibility for exemption from renegotiation under certain provisions of the Renegotiation Act referred to in the subject stipulation, the court is justified in considering the point waived.

War and National Defense ⟸ 59

*Gordon Gerber*, for plaintiff. *Gilbert A. Cuneo*, attorney of record. *James J. Gallagher*, *Alfred A. Gollatz*, *Dechert Price & Rhoads*, of counsel.

*Richard J. Webber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Robert E. Tressel*, of counsel.

---

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and BENNETT, *Judge*.

BENNETT, *Judge*, delivered the opinion of the court:

This renegotiation case is before the court on the parties' cross-motions for summary judgment. The parties have stipulated that if the plaintiffs' defense-related contracts are held subject to the Renegotiation Act of 1951, as amended, 50 U.S.C. APP. §§ 1211 *et seq.* (1970), then plaintiffs, renegotiated as a consolidated group, *see* 50 U.S.C. APP. § 1215(a) (1970), realized excessive profits of $1,515,000. We now hold that the contracts at issue are subject to the provisions of the Act.

The two plaintiffs, Comprehensive Designers, Inc. (CDI) and its British-based subsidiary, Comprehensive Designers International Limited (CDIL), entered into requirements contracts with American defense contractors to perform certain personnel and office supply services in their fiscal year 1967. CDI's primary contractor-client was the Lockheed-Georgia Division of Lockheed Aircraft Corporation (Lockheed);[1] CDIL's nearly exclusive client was Lockheed. At that time Lockheed was engaged in designing and building the C–5A aircraft for the Government, and was in need of additional engineering and technical personnel for a temporary period. Plaintiffs were in the business of recruiting such personnel to perform work for other firms at the firms' direction, and were awarded contracts by Lockheed under which plaintiff would submit engineers' and technicians' resumés to Lockheed. Several other contractors like the plaintiffs were also given these requirements contracts. They then competed with one another for the placement of personnel with Lockheed, for Lockheed alone determined whom it would hire, and for what duration. However, it was only upon the hiring of the employee that any profit accrued to the personnel contractor.

Plaintiffs received payments from Lockheed covering the salaries, taxes, and fringe benefits of the personnel offered by plaintiffs and hired by Lockheed, along with a profit for plaintiffs. CDIL in addition performed such functions for Lockheed as the rental of office space and the rental or purchase of office supplies and engineering equipment; it received fees covering its expenses for these functions, plus a profit. Plaintiffs carried the Lockheed-hired personnel on their payrolls and performed all the necessary tax and fringe-benefit accounting. Lockheed at all times controlled the temporary employees' working hours and activities, approved their vacations, commingled them with its permanent staff, and retained the right to terminate any or all of them without cause.

The Renegotiation Act makes subcontracts with defense contractors subject to its provisions. It defines "subcontract,"

[1] The parties have agreed to treat all of CDI's 1967 defense-related work as if performed under the Lockheed contract.

in section 103(g), 50 U.S.C. APP. § 1213(g) (1970), to mean "(1) any purchase order or agreement * * * to perform all or any part of the work, or to make or furnish any materials, required for the performance of any other contract [subject to renegotiation] * * * but such term does not include any purchase order or agreement to furnish office supplies * * *." A Renegotiation Board regulation, 32 C.F.R. § 1452.4(b)(1) (1967), elaborates on this definition:

> * * * An agreement * * * is a renegotiable subcontract if it is: (i) For the sale or processing of an end product which is to be delivered under a renegotiable prime contract; or (ii) for the sale or processing of materials to be physically incorporated in such end product; or * * * (v) for the performance of services directly required for the performance of prime contracts * * * included in (i) [or] (ii) * * * of this subparagraph.

Defendant maintains that plaintiffs performed services "directly required" for the processing of a renegotiable end product or its material components when they sent qualified personnel to Lockheed to work on the C–5A's design, and then managed the related payroll accounting. Opposing this, plaintiffs argue that Lockheed's control of the temporary employees' work activities was so pervasive that the employees must be considered to have done their work in Lockheed's name alone. Defendant's response is that, no matter who was responsible for the employees' daily activities, the definition of "subcontract" in the statute and regulations is extremely broad and reaches all who contribute to creating higher prices for the Government in the course of making products for it, citing *Providence Wool Combing Co.* v. *Secretary of War*, 14 T.C. 979 (1950).

*Providence Wool*, an early renegotiation case, arose under the Renegotiation Act of 1942 but involved the same definition of subcontract and the same legislative history of that definition as this case. There, the Tax Court considered the scope of renegotiation sufficiently expansive to touch most every subcontractor who contributed in some fashion to the creation of the product purchased by the Government. After reviewing the legislative history of "subcontract," the court

held that the term permitted the renegotiation of a wool processor who sold to private firms, having no Government contracts, but whose wool was ultimately incorporated in goods the Government bought. The court referred to the "mischief at which the legislative remedy was aimed," war profiteering, as authority to view the scope of "subcontract" expansively.

In enacting the renegotiation statute, Congress wished to deflate, retroactively, any Government-paid prices (and therefore profits) which were abnormally high due to the lack of adequate price competition in wartime conditions. *Major Coat Co.* v. *United States*, 211 Ct. Cl. 1, 543 F. 2d 97 (1976). It did not want the profit-recoupment task arbitrarily stopped short of totally compensating for market aberration, as the *Providence Wool* opinion noted in speaking of the "mischief" and the "remedy." When a subcontractor charges a defense contractor a certain price for services, that price becomes part of the price to the Government on the end product, yet it is not renegotiable as far as the prime contractor is concerned, for it is only a deductible renegotiable cost to him. If the subcontractor's abnormal profit, realized solely because of wartime conditions, cannot be recouped directly from him, it is not touchable at all. This argues, as the Tax Court recognized, for the broadest possible reading of the term "subcontract." The legislative history discussed in *Providence Wool* does not support exemption of the present personnel contracts from renegotiation.

Plaintiffs, for the benefit of CDIL's office space and supply acquisition functions, point to section 103(g)(1)'s exclusion of "agreement[s] to furnish office supplies" from the definition of subcontract. They note that the Renegotiation Board itself excludes from the definition of subcontract, agreements for office machines, furniture, and equipment, even though the statutory exclusion does not cover these items. 32 C.F.R. § 1452.4(b)(2) and (b)(3) (1967). However, these exceptions from the Act's coverage merely reflect the thought that the sale or rental of standard off-the-shelf items at commercial rates is not likely to give rise to excessive profits; the assumption is that adequate price competi-

tion will always protect the Government in this area. Plaintiff CDIL's office supply services, for a fee quite apart from the office and equipment acquisition costs, stand on a much different footing than standard off-the-shelf sales. They lie outside the exclusion and are just as rife with economic "mischief" as are plaintiffs' personnel services.

Plaintiffs insist that their services must be "integrally related" to the prime contractor's end product, or materials incorporated therein, in order to be renegotiable. In this they rely on the regulation's reference to services "*directly*" required for the performance of the prime contract, 32 C.F.R. § 1452.4(b)(1)(v) (1967), quoted above. Placing much emphasis on a "direct-indirect" distinction poses many problems, for no one knows exactly where "direct" leaves off and "indirect" begins. The matter is judgmental, the inquiry is whether including a given activity in the definition becomes too attenuated, and the result is necessarily guided by policy concerns underlying the statutory and regulatory scheme. We think that the economic considerations discussed above must control the interpretation of whether a certain subcontract has a "direct" impact on the prime contract. It follows, for reasons previously stated, that plaintiffs' contracts with Lockheed fall within the provisions of the Renegotiation Act.

Plaintiffs' motion for summary judgment is denied, and defendant's cross-motion is granted. We conclude and determine that plaintiffs realized excess profits in the amount of $1,515,000, for the fiscal year ended April 30, 1967, less appropriate credits to plaintiffs for federal and state taxes, and otherwise, as agreed in the parties' stipulation filed September 23, 1976. The net amount owed to defendant will bear interest as stipulated.[2]

---

[2] The stipulation recited that the court would also be asked to consider plaintiff's eligibility for exemption from renegotiation under section 106(e)(1)(B) and (4)(C) of the Act, 50 U.S.C. App. § 1216(e)(1)(B) and (4)(C) (1970), relating to exemptions for so-called standard commercial services. Since neither party has mentioned plaintiffs' eligibility for such exemption either in the briefs or at oral argument, we consider the point waived and decline to address it.

Syllabus

552 F. 2d 922

# PETER GOUTOS v. THE UNITED STATES

[No. 361–74. Decided December 15, 1976. Plaintiff's motion for rehearing denied Feb. 4, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; detailed v. appointed to position.**—Plaintiff, a GS–13 Deputy Chief, Repair and Utilities Division, was officially detailed to the position of Acting Chief, Buildings and Grounds Division (B&G), serving in the latter position from September 1969 to February 1972, during which period the position of Chief was upgraded from GS–13 to GS–14. A recommendation that plaintiff be appointed Chief, B&G, was not acted upon by the Civilian Personnel Officer. On February 1972 a competitive selection process was initiated to fill the upgraded position and, although plaintiff was a candidate, another was selected. Plaintiff was reassigned to another GS–13 position. On plaintiff's appeal on the ground that he suffered a reduction in rank, the Appeals Examining Officer held in plaintiff's favor; the Board of Appeals and Review reversed on the ground that plaintiff was never *appointed* to the position of Chief. In plaintiff's suit seeking a retroactive appointment to Chief of B&G, promotion from GS–13 to GS–14 and back pay from the date of promotion, it is *held* that the decision of the Board of Appeals and Review did not violate applicable statutes or regulations, nor was the Board's action in overturning the determination of the Appeals Examining Officer arbitrary or capricious. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Civilian pay; appointment and tenure; generally.**

[1] Standard Civil Service Commission Form 52 is merely a request for appointment to a position, and until the form is signed by the proper authority signifying approval it is not an appointment.

Officers ⟸ 13

**Civilian pay; appointment and tenure; generally.**

[2] A Government employee is entitled only to the rights and salary of the position to which he has been *appointed* by one having the proper authority to do so.

United States ⟸ 39(2)

**Civilian pay; appointment and tenure; generally.**

[3] An appointment to a civil service position is not made until the last act required by the person or body vested with the appointment power is performed. The fact that plaintiff remained in the position to which he was detailed longer than the designated 120 days does not evidence tacit approval of a permanent appointment. Having

**accepted the benefit of the detail, plaintiff is estopped from attacking its legality.**

Officers ⇐ 13

*Gary B. Landsman*, attorney of record, for plaintiff.

*John W. Showalter*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before NICHOLS, KASHIWA, and KUNZIG, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court.

This civilian pay case comes before the court on plaintiff's and defendant's cross-motions for summary judgment. Plaintiff seeks a retroactive appointment to Chief, Buildings and Grounds (B&G) Division, Job. No. 6442–S, Facilities Engineering Directorate, U.S. Army Engineering Command, Frankfurt, Germany. Further he seeks promotion from GS–13 to GS–14, and back pay from the date of promotion. The parties present two issues. The first is whether plaintiff was ever officially appointed to the position of Chief, B&G. The second is whether, assuming that plaintiff was appointed, he is entitled to noncompetitive promotion to the now-upgraded position. As we uphold the Civil Service Commission Board of Appeals and Review (BAR) finding that plaintiff was never appointed, we grant defendant's motion for summary judgment dismissing the complaint without reaching the second issue.

The facts of this case involve a series of appointments, assignments, and detailings at the conclusion of which plaintiff believed himself to be improperly demoted. Plaintiff is a Civil Service employee of the Department of the Army. In 1969, plaintiff, a GS–13 appointed as Deputy Chief, Repair and Utilities (R&U) Division, was officially detailed to the position of Acting Chief, B&G Division, for a period not to exceed 120 days. Shortly thereafter, he was recommended for appointment to the position of Chief, B&G Division, by the Director of the Facilities Engineering Directorate. However, this recommendation was never acted upon by the Civilian Personnel Officer (CPO). Notwithstanding the lack of action, plaintiff served as Acting Chief from September 1969 to February 1972.

Opinion of the Court

While plaintiff was in the position of Acting Chief, the Chief's position was upgraded in 1970 from GS–13 to GS–14 as part of a review of all B&G personnel. The position description remained the same. After the upgrading, a competitive selection process was initiated to fill the position of Chief, B&G Division. Plaintiff's name was on the list of candidates, but he was not selected. He was redetailed to the position of Deputy Chief, B&G Division (GS–13) in February 1972 after another candidate was appointed to the position of Chief.

Following an intervening assignment not pertinent to this case, plaintiff was officially reassigned from his appointment as Deputy Chief, R&U Division, and appointed Supervisory Civilian Engineer, Assistant Chief, B&G Division (GS–13).

Plaintiff filed a timely appeal of this reassignment, arguing that he had suffered a reduction-in-rank based on his alleged service as Chief, B&G Division, a position which was upgraded to GS–14 level during his tenure as Acting Chief. The Appeals Examining Officer (AEO) agreed. The agency appealed, and the BAR reversed the AEO's decision on the ground that plaintiff was never appointed to the position of Chief, merely detailed as Acting Chief. The BAR did not reach the question of whether plaintiff was entitled to a noncompetitive promotion when the job was upgraded. Plaintiff then filed suit in this court.

Plaintiff argues that he was properly assigned to the position of Chief, B&G Division, and reasons from this point that the BAR's decision was arbitrary and capricious, that he was improperly removed from the position as Chief, that he is entitled to a noncompetitive promotion, and that his reassignment in December 1972 was a reduction-in-rank.

Defendant counters by stating that plaintiff was never appointed to the position of Chief, B&G Division. As plaintiff was never officially appointed, the decision of the BAR is not arbitrary and capricious. Defendant then contends, arguendo, that even if plaintiff was appointed Chief, B&G Division, he was not entitled to a noncompetitive promotion to GS–14 when the position was upgraded.

At issue is whether plaintiff can claim a valid appointment to the position of Chief, B&G Division, absent the CPO's

execution of form 52,[1] officially appointing plaintiff to the position. As we hold, under the facts of this case, execution of the form is the *sine qua non* to plaintiff's appointment, we agree with defendant's position and dismiss the complaint without reaching the noncompetitive promotion issue.

It is settled law that a Government employee is entitled only to the rights and salary of the position to which he has been *appointed* by one having the proper authority to do so. *Peters* v. *United States*, 208 Ct. Cl. 373, 377, 534 F. 2d 232, 234 (1975); *Desmond* v. *United States*, 201 Ct. Cl. 507, 525–26 (1973); *Coleman* v. *United States*, 100 Ct. Cl. 41, 43 (1943); *Jackson* v. *United States*, 42 Ct. Cl. 39, 41–42 (1906). In this case, the person with the authority to appoint was the CPO at Frankfurt.[2] Yet the CPO never acted on repeated requests from plaintiff's Director that the form 52 be executed appointing plaintiff to the position of Chief.

Plaintiff cannot expect the court to draw the positive action of appointment from the CPO's inaction, although this is the position plaintiff appears to take. First, it is difficult to believe that if the CPO wanted plaintiff appointed, he would have failed to sign the form 52 in the face of repeated requests by the recommending officer. Second, even if the facts were not so clearly against plaintiff,[3] it has long been the law that an appointment is not made until the last act required by the person or body vested with the appointment power is performed. *Marbury* v. *Madison*, 1 Cranch (5 U.S.) 137 (1803); *D'Arco* v. *United States*, 194 Ct. Cl. 811, 816, 441 F.

[1] Form 52 is a standard Civil Service Commission form used (with a few exceptions not relevant to this case) throughout the Government. Its title, "Request for Personnel Action," denotes the fact that until the form is signed by the proper authority signifying approval, the form remains merely a request for appointment, not an appointment itself. *See Doggett* v. *United States*, 207 Ct. Cl. 478, 482 (1975); *D'Arco* v. *United States*, 194 Ct. Cl. 811, 816, 441 F. 2d 1173, 1175 (1971).

[2] The Civilian Personnel Officer's authority derives from a line of delegations beginning with Article II, section 2, paragraph 2 of the United States Constitution and ending with the delegation of the appointment power to the CPO by this U.S. Army (Europe) major command. Department of the Army, General Order 82 (July 19, 1956); USAREUR Reg. 690–1 (Jan. 21, 1972). The CPO is without authority to further delegate the power to appoint. USAREUR Reg. 690–1, *supra*.

[3] We note that plaintiff has not offered any affidavits alleging mistake, improper conduct, or lost documents. Such allegations might concededly lead us to a different result, but such allegations are not before the court in the instant case. *Cf. Hirsch* v. *United States*, 205 Ct. Cl. 256, 260, 499 F. 2d 1248, 1250 (1974); *Urbina* v. *United States*, 192 Ct. Cl. 875, 80–81, 428 F. 2d 1280, 1283–84 (1970).

Syllabus

2d 1173, 1175 (1971); *Gorman* v. *United States*, 102 Ct. Cl. 260, 270 (1944). Here the final act required was the signature of the CPO on the form. The CPO never signed, so plaintiff was never appointed.

To infer appointment under these facts could easily bring about chaos in government personnel management. Appointments could take effect automatically, even upon the knowing failure of an appointing official to act. The result would be that the person with the power to recommend would also obtain the power to appoint in direct contradiction of official regulations.

Further, the fact that plaintiff remained in the detailed position longer than 120 days does not evidence tacit approval of a permanent appointment. As this court said in *Peters*, *supra*, having accepted the benefit of the detail, plaintiff is now estopped from attacking its legality. 208 Ct. Cl. at 378, 534 F. 2d at 235; *Steuer* v. *United States*, 207 Ct. Cl. 282 (1975).

In conclusion, upon examination of the facts of this case, and for reasons enumerated above, we cannot say that the BAR decision violated any applicable statutes or regulations, or that the BAR acted arbitrarily or capriciously in overturning the AEO's decision. Rather, we find the BAR decision persuasive.

Accordingly, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and the petition is dismissed.

---

546 F. 2d 357

## INSTRUMENT SYSTEMS CORPORATION AND HAROLD BECK v. THE UNITED STATES

[Nos. 338-73 and 339-73. Decided December 15, 1976]

ON DEFENDANT'S REQUEST FOR PROMPT REVIEW

**Renegotiation of contracts; discovery; production of documents; allowable scope of discovery; Freedom of Information Act; reference of procedural motions to court.**—Plaintiff seeks redetermination of excessive profits allegedly received during its fiscal years ended July 31, 1967 and 1968. In this phase of the litigation, the court, at defendant's request under Rule 53(c)(2)(ii), has decided

Syllabus

to review the trial judge's order of February 13, 1976 (reconsideration declined by order of April 7, 1976) granting plaintiff's request, and directing defendant to produce, for inspection and copying the Renegotiation Board Form No. 1 (RB–1) with accompanying schedules filed with the Board by plaintiff's direct competitors or companies which operated in a related area during or about the review years, the names of the companies and other identifying details to be excised. For purposes of decision, the court assumes that access to the full RB–1's contemporary to the review years may possibly lead to discovery of relevant evidence even if the forms themselves are not such relevant evidence. Review was granted on the basis that fundamental rights of third parties as well as defendant's are involved, and in order to lay down a positive procedure so that discovery of renegotiation documents filed by or relating to contractors not before the court will not vary between trial judges. It is *held* that third parties not before the court have a right to be notified and to be heard respecting the decision as to discovery of their financial data, etc. not otherwise available under the Freedom of Information Act, and that this should be done on a case by case basis. The court sets forth the procedure to accomplish this, although if the procedure imposes too heavy a burden on the Trial Division modification thereof may be necessary. The trial judge's order under review is vacated, and the cause is remanded to the Trial Division for further proceedings consistent with the opinion.

**Renegotiation of contracts; discovery; production of documents; Freedom of Information Act.**

[1] Consonant with other court decisions interpreting the Freedom of Information Act, anyone may obtain from the Renegotiation Board documents revealing the later history of a case started by a Renegotiation Board Form No. 1, including corrections of errors in the financial data of defense contractors accompanying said form and the Board's decision, only the data as to non-renegotiable business being excluded. This court does not have jurisdiction to review such decisions.

Records ⟸ 14

**Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.**

[2] A renegotiated contractor's mere prima facie case as to the statutory factors on which it relies, sufficient within the meaning of *Lykes Bros. S.S.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972), need not include data as to the business of third parties to the litigation, outside that available to all under the Freedom of Information Act. The contractor may accept as correct part of the Board factor analysis, as to some factors, and show that the Board has done injustice with respect to others, thus stressing what the contractor best knows—its own business.

War and National Defense ⟸ 59

Opinion of the Court

**Renegotiation of contracts; redetermination of excessive profits; information required of contractors.**

[3] The Renegotiation Board Form No. 1, whether or not non-renegotiable and total business data is excised, will not normally provide a comparison of other contractors to set against the contractor under review. It is more a lead to discovery of meaningful comparisons than the basis of such comparisons itself. A comparison that does not point out similarities and discount differences is as superficial as composite comparisons of comparable industry.

War and National Defense ⇐ 59

**Renegotiation of contracts; discovery; production of documents; allowable scope.**

[4] In judicial redetermination of a contractor's excessive profits, the decision respecting discovery of third party's financial data, etc. demands case by case consideration, balancing need for evidence against threatened injury to the third party, the contractors' reasonable expectations of confidentiality when they filed their Renegotiation Board Form No. 1, and the lapse of time, if long, between filing of a third party's Form No. 1 and its use in this court, as to which decision the third party has a right to be notified and to be heard. Unless the third party consents to the disclosure, the balancing of necessity and injury must be made with respect to the individual Form No. 1, not with respect to all of them as a class. However, any procedures the court prescribes should not give the Government an unfair advantage resulting from having custody of all Forms No. 1. Defendant must respect the privacy rights of both the renegotiated contractor and the third parties not before the court.

War and National Defense ⇐ 59

*Robert B. Yorty*, attorney of record for plaintiffs. *Lowell J. Bradford*, *Gordon W. Hatheway*, *Jr.*, and *Pierson, Ball & Dowd*, of counsel.

*Gerald L. Schrader*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Don W. Crockett*, attorney, Renegotiation Board, of counsel.

---

Before NICHOLS, KASHIWA and KUNZIG, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

These are petitions for redetermination by this court of the plaintiff's excessive profits received or accrued for its fiscal years ended July 31, 1967 and July 31, 1968, as determined by the Renegotiation Board under the Renegotiation Act of 1951, 50 U.S.C. App. § 1211 and ff. In the course of

pre-trial proceedings a dispute has arisen concerning the scope of discovery allowable to the plaintiff. Trial Judge Louis Spector has issued, on February 13, 1976, an order with respect thereto, declined to reconsider it, on April 7, 1976, and refused to certify existence of "an issue of controlling importance or an issue involving deprivation of fundamental rights, as to which there is substantial ground for differences of opinion". Rule 53(c)(2)(i). Defendant has nevertheless requested review under the narrower subsection (ii) of the Rule. We deem that the standards of that subsection are met and therefore have decided to grant review, the fundamental rights of third parties as well as defendant's being involved in our opinion, and injury being threatened, which could not be corrected by any ultimate disposition of the case. Our statement of the issue and our conclusions follow.

The disputed order recites that plaintiff seeks to inspect and copy certain Forms RB–1 which, with attached schedules, were filed with the Renegotiation Board by competitors of the plaintiff, or companies which operated in a "related area". It seems to be agreed that only those are sought which concern years approximating the "review years" which ended respectively more than eight and nine years before this decision. The order states that Form RB–1 is "the last stage in the Board's long process of analyzing the underlying information which led to [the Board's] conclusions." The trial judge refers to this on reconsideration and possibly but ambiguously corrects the mistake. Actually, it is the first stage: the initial filing the Board uses to decide whether it will commence the renegotiation. Called the "Standard Form of Contractor's Report" it is prescribed in RBR § 1470.3 and ff., 32 C.F.R. § 1470.3. Upon receipt of the RB–1 the Board decides whether to commence a proceeding, RBR § 1472.2. In cases the statute clearly does not cover, a "statement of non-applicability" is permitted in lieu of the RB–1. It is in either case a contractor's *ex parte* statement not yet corrected as the Board usually must do if it is to initiate a renegotiation, or if the decision whether to do so is at all a close one. Nevertheless, we will assume for purposes of our decision, at least, that access to the full RB–1's con-

temporary to the review years may possibly lead to the discovery of relevant evidence even if the forms themselves are not such relevant evidence. Rule 71(b)(1).

The order, however, asserts that the RB–1's are relevant evidence on the theory that comparisons with other individual companies are an indispensable part of renegotiation. We discuss this further below. As regards confidentiality, the order states that exemptions from disclosure under the Freedom of Information Act (FOIA) (5 U.S.C. § 552(b)(3) and (4) are presumably the parts referred to) are not necessarily for application in litigation where a need is demonstrated, relying mainly for authority on prior trial judge's decisions in this court. The order provides that the names of the contractors and other identifying details are to be excised and recites that counsel has agreed not to disclose the data to his client. "Any problems relating to the introduction of the data into evidence, will abide that event."

In connection with its request for review, and in oral argument, defendant advises that despite the exemption in the FOIA, supra, for:

> (4) * * *
>
> (4) trade secrets and commercial or financial information obtained from a person and privileged or confidential;

the Board normally will furnish anyone on request the RB–1 with the contractor's name included; however, the columns for non-renegotiable and for total business (A and E) are masked out. Apparently, schedules and supporting tax returns, etc., are also not provided. By comparing and correlating his discovery and his FOIA data counsel could make the deletion of the contractor's name and other identifying detail from the discovered RB–1's a meaningless ritual, and the reasons, except cosmetic, for requiring this, are far from obvious. Similarly, under the FOIA, anyone can obtain from the Board documents revealing the later history of the case the RB–1 started, with any errors in the financial data corrected, and with the Board's decision revealed, only the data as to non-renegotiable business being excluded as before.

This procedure does not originate in a mere whim of the Board, but reflects the outcome of litigation in the United States courts for the District of Columbia. *Grumman Aircraft Engineering Corp.* v. *Renegotiation Board*, 425 F. 2d 578 (D.C. Cir. 1970); *Fisher* v. *Renegotiation Board*, 473 F. 2d 109 (D.C. Cir. 1972), *on remand*, *Fisher* v. *Renegotiation Board*, 355 F. Supp. 1171 (D.D.C. 1973); *Pacific Architects & Engineers, Inc.* v. *Renegotiation Board*, 505 F. 2d 383 (D.C. Cir. 1974). We do not have jurisdiction to review these or other FOIA decisions and do not do so. We assume that what the Board has done is what it had to do. If the reasonable expectations of privacy that contractors entertained, when they filed data with the Board, have been disappointed, this is the responsibility of the Congress that enacted the FOIA and the courts that interpret and apply it. However, we note that the companies who furnished the data were not so far as appears, parties to the above cited litigations. When such parties initiate litigation on their own account, to enjoin unauthorized administrative disclosure of their confidential financial and technical data, the FOIA takes on a different aspect. *Westinghouse Elec. Corp.* v. *Schlesinger*, 542 F. 2d 1190 (4th Cir. 1976). The court therein notes that Government agencies having custody of confidential business data are not likely to be as effectual opponents of disclosures of it, allegedly but not really required by the FOIA, as are the companies the disclosure will hurt.

In this instance the record does not reveal that the parties who supplied the involved RB–1 data have had any notice of the proposed use of the material they supplied to the Board, still less what their reaction would be, did they know. Defendant purports to speak as a surrogate on their behalf, also alleging that it will be unable to obtain willing compliance with the reporting requirements of the Renegotiation Act in the future. In view of the lapse of time, it is difficult to assess what the real or anticipated injury would be. Defendant does not purport to state the views of those actually concerned. It only proffers selected views of members of the defense contractor community, who may have filed RB–1s, but not the ones which would be divulged under the order here involved.

Reporting under the Act is clearly mandatory, and one who objected to disclosure of reports could make his objection fully effective only by rejecting defense business, if then. For one who decided on that drastic step the disclosure of reports could hardly be more than a minor factor, renegotiation itself would weigh more.

Defendant also complains of conflicting decisions by other trial judges in other cases. It is clear that unless we grant this review, and lay down a positive line, the discovery of renegotiation documents filed by or relating to contractors not before the court will vary widely according to which trial judge is assigned the case. We summarize the instances defendant relies on.

1. *Marinette Marine Corp.* v. *United States*, *post* at 114, 546 F. 2d 365 (1976). Plaintiff has petitioned for prompt review in that case, and it was argued immediately following the one at bar, before the same panel. It will be dealt with in an opinion issuing concurrently with this, and is referred to frequently hereinafter. Plaintiff demanded discovery of 27 RB–1s filed by its competitors in the shipbuilding industry. Trial Judge Miller required defendant to communicate with the companies involved. Their responses in several instances included formal motions for protective orders. Others just objected by letter. Some did not respond and some waived objection. The objectors in several instances were apparently unaware that, except for data as to non-renegotiable business, plaintiff already had access to their filings via the FOIA, without their having anything to say about it. The trial judge refers to defendant's "error" in not excising names and identifying details, as if defendant had any option in the matter. He seems to feel that defendant voluntarily elected a course of action that might lead to limitations on discovery here, not otherwise necessary. He allows the discovery; however, he requires plaintiff's counsel to return his FOIA material with respect to any filing as to which he is allowed discovery here. The names and other identifying details are to be excised; counsel is not to disclose data to his client, but only to his accountant and his "assistants," which term apparently may include retained expert witnesses. Parts of the order deal with other matters and are left to the other opinion.

2. *Major Coat Co.* v. *United States*, No. 31–72. Trial Judge Willi held, on November 21, 1973, that the Government was not the owner of the RB–1 material, but only a bailee or custodian. If plaintiff wanted discovery of it, beyond the FOIA limits, it would have to pursue discovery directly with the filing contractors. Defendant submits that this is the correct position. We note that the court has now decided this case on the merits, 211 Ct. Cl. 1, 543 F. 2d 97 (1976). Some comparable companies are referred to by name; how the data was obtained is not spelled out. The court complains that the comparative data is inadequate. We discuss this highly significant decision further on, as to other aspects.

3. Shortly after Trial Judge Willi's above decision, Trial Judge Schwartz took the opposite point of view in *Consolidated Box Co.* v. *United States*, No. 622–71, and later on, in *Menominee Engr. Corp.* v. *United States*, No. 214–74. He holds that a document is not immune from discovery because it is confidential. He weighs the plaintiff's need, which he finds great, against the possibility of injury, which he finds unimpressive in view of the age of the material. He notes that none of the filers of RB–1's here intervened. He presumes that defendant has either advised such parties that they may intervene, and none have chosen to do so, or that defendant has concluded it could not expect support from that source. In view of the responses obtained in the *Marinette* case, such presumptions appear unrealistic. Defendant clearly thinks that if anyone is to notify the other contractors, it should be plaintiff. That was its retreat position here, if we rejected the Willi view. Judge Schwartz requires counsel not to disclose the data to his client, or to others than his accountant and "assistants". The names and other identifying details are to be excised. This last would appear to be no more than cosmetic in view of the availability of the FOIA data, which counsel is not required to surrender.

On oral argument, defendant admitted that its long-range policy was to keep out of our renegotiation cases entirely, all use of specific third party company data for comparison purposes. This, although it cannot be denied that the Board uses them extensively, as its regulations in many places dis-

close. Defendant would have the court use, instead, composite data assembled by the IRS or otherwise.

As noted in *Aero Spacelines Inc.* v. *United States*, 208 Ct. Cl. 704, 530 F. 2d 324 (1976), the Tax Court before the transfer of cases here insisted on meaningful comparative data. We have repeatedly complained of the absence or thinness thereof in the cases that have come before us on the merits. *Aero Spacelines*, *supra; Major Coat Company; supra*, *Butkin Precision Mfg. Co.* v. *United States*, 211 Ct. Cl. 110, 544 F. 2d 499 (1976). In *Aero Spacelines*, 208 Ct. Cl. at 730, 530 F. 2d at 340–41, we said:

> Despite the importance of meaningful comparative data, neither party to this suit has made a significant effort to bring such information before the court. The absence of helpful comparisons characterized both plaintiff's prima facie case and the Government's response. The defendant, which bears the ultimate burden of proving both the existence of excessive profits *and the extent of those profits* necessarily fares worse than does plaintiff for lack of this information. (Emphasis in original).

The insufficiency of comparison with composites has been emphasized almost as often. This topic is stressed in *Major Coat* and *Butkin*, both *supra*. In *A. C. Ball Co.* v. *United States*, 209 Ct. Cl. 223, 531 F. 2d 993 (1976), the composite statistics on salaries paid executives in "comparable industry" were held to have "only limited applicability", in determining the reasonableness of executive salaries in the company under review, in a case where such salaries were a vital and determinative issue.

We think that after study of our latest cases, defendant will likely conclude that the goal of substituting composite comparisons for individual ones is not attainable and that the outcome of persisting in it is likely to be as in *Aero Spacelines* and *Butkin*, that defendant will be held not to have sustained its burden of proof that any excessive profits at all were realized in the years under review.

It may clarify thought to remind lawyers of something they all are familiar with: the use of sales of comparable property to determine in legal proceedings the fair market

value of real estate. Would it be accepted as rational to assemble a lumped average composite of sales of homes, apartment houses, office buildings, garages, churches and warehouses, and offer that as a substitute for even one simple sale that actually took place in the real world? Would it be reasonable to offer the sale of any single building with the identity and location of it blanked out?

On the other hand, it is necessary to prevent the renegotiation of one contractor being magnified by counsel into the renegotiation of all its competitors. Once the most immediately relevant data of the other case is at hand, inquiry into all its ramifications must be resolutely halted.

We also note that the plaintiffs here involved, in their persistent demands for discovery over and above the liberal FOIA standard, seem to disbelieve that this court meant anything significant in *Lykes Bros. S. S.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972), wherein we said that defendant bore the ultimate burden of proof, but the contractor had the initial burden of going forward, with proof of a prima facie case (after the accounting data was established) as to the statutory factors on which it relied, with proof of facts within plaintiff's knowledge, or accessible to the public generally in the form of published reports, or voluntarily made available by the Government through a request in pre-trial proceedings, or by discovery through the court rules, or pursuant to FOIA.

It was not our intention, of course, to say that the prima facie case was the same as a complete and entire case, so that the burden of proof on plaintiff to make its prima facie case was the same as the complete burden as it was in the Tax Court. If this had been our intention, there would have been no point in the preliminary deliberations, whether we should adhere to or abandon the previous Tax Court rule. Rather our idea was that while throwing the burden on defendant, we should require plaintiff to show that it had acted responsibly in invoking the processes of this court, and not just for purposes of delay. Since plaintiff had chosen whether this court should function in the premises or not, we thought a modest showing of probable cause was reasonable. In *Aero Spacelines* and *Butkin*, *supra*, we have established lenient

standards as to what constitutes a prima facie case. We certainly did not envisage that, to make a mere prima facie case, plaintiffs would have to embark on bitterly contested moves to infringe or reduce the legally protected privacy of parties not involved in the litigation in this court. To make the matter completely clear, we now determine that a mere prima facie case, sufficient within the meaning of the *Lykes* case, need not include data as to the business of third parties to the litigation, outside that available to all under the FOIA. Plaintiff may accept as correct part of the Board factor analysis, as to some factors, and show that the Board has done injustice with respect to others, thus stressing what the contractor best knows, its own business.

It is reasonable to suppose that in view of the foregoing, the sense of urgency on the part of defendant to exclude all specific comparisons from the case will be diminished, and it may realize its own need for such comparisons, to sustain its burden of proof. On the other hand, plaintiffs may be more satisfied with their FOIA material and may be content to await what else, if anything, defendant brings forth. Any rule we lay down should be written in anticipation of this possible future situation, and not deal merely with the stands of the parties that confront us now.

At the outset we are constrained to observe that the cold RB–1 as set forth in RBR § 1470.90(c), whether or not mutilated by deletion of non-renegotiable and total business data, will not normally provide a comparison to set against the contractor under review, in and of itself. It is obviously not intended for anything but preliminary screening. It does not afford any basis for an opinion as to how the filing party would compare with any other company under the factors, taken separately. Thus if the filing party made, *e.g.*, a creditable contribution, or suffered losses after the year under review (*cf. Butkin, supra*) there is no place on the form to show it. It seems clear, therefore, that for our present purposes, the RB–1 is more a lead to the discovery of meaningful comparisons, than the basis of such comparisons itself. It is reasonable to suppose that any selected comparison company will be similar as to some factors and different as to others. To make a meaningful comparison, it will be necessary to

point out the similarities and to discount the differences. A comparison that does not do this is bound to be just as superficial as the composite comparisons we have already discussed.

The financial data on the front of the RB–1 lumps together all the products the company produces. Only on the back, in Sec. IX is a breakdown by product asked for, but it is plainly of the most superficial character.

The mutilation of the form by deletion of the non-renegotiable and total columns, (A and E) will have an entirely different impact on the informativeness of the filing, depending on whether the party has significant non-renegotiable business or not (many do not) and, if it does, whether it is a matter of different products, made in different plants, or the same products, made in the same plants. When, as so often, volume and its war-caused increase or decrease is a significant factor in the decision, the elimination of the non-renegotiable sales of a principal renegotiable product, will be a crucial mutilation. When the same plant produces different products, determining the cost of one as against the other is an eminently inexact science, and the allocation of costs and profits, among these products may be an object of some scrutiny, even if the RB–1 is prepared by independent CPA's of high repute. The contractor is therefore required to reveal the method of allocation, but if one cannot see and compare the costs and profits actually allocated to each segment, it is impossible to draw any but superficial conclusions.

Similarly, and for similar reasons, assuming that columns B, C and D are made available to the public, with whatever injury caused thereby left without a remedy, how much additional harm is caused by revealing columns A and E, and certain schedules, or saved by not doing so, will not be uniform but will vary widely from case to case.

The excising of the name and other "identifying details" would seem to frustrate the use of the RB–1 as a lead to other evidence, the principal use it would appear to have. And whether the mutilation serves any protective purpose is open to doubt. Clearly none, if the discovering party can use its FOIA material to complete its identifications of RB–1's with only identification concealed, as in the order

immediately before us. It is to be supposed that even without this help, in many industries, contractors know enough about their competitors to recognize their financial data. It displays commendable faith to tell counsel he cannot disclose the material except to his accountant and his "assistants", but none of the orders we consider deal with what may happen if the material is offered in evidence at the trial. Is the client to be excluded from the courtroom? Our trial judges all agree in deferring consideration of this problem until it arises. No doubt this reflects wise statemanship, but one who is started walking down the plank may wish to know what happens if he falls into the water.

Agreeing as we do with our trial judge that the decision respecting discovery is to be made by balancing need for evidence against threatened injury to the third party, and that the contractors' reasonable expectations of confidentiality, when they filed their RB–1's, are entitled to be considered but are not necessarily controlling here, and agreeing further, that the long lapse of time between filing of a third party's RB–1, and its use here, must notably diminish the likelihood of such injury, we are constrained to disagree that the matter is susceptible to handling by any across the board order, no matter how astutely framed. It demands case by case consideration in which the party who filed the RB–1 has a right to be notified and to be heard, and unless he consents to the disclosure, the balancing of necessity and injury is made with respect to the individual RB–1, not with respect to all of them as a class. If our analysis of the situation has any validity at all, it establishes that the factors of necessity and injury will not be the same for all RB–1s, but will vary wildly from one to another.

Since we anticipate that defendant will wish to make comparisons in future cases, any procedure we prescribe should not give defendant any unfair advantage resulting from having custody of all RB–1s in Government files. It has raised serious questions as to privacy rights, seeking to speak as surrogate for parties not before us, except in the *Marinette* case, where we have several petitions by third parties for protective orders. It must respect these rights equally with its adversary.

It is also realistic to recognize that in many or most instances the information in the RB–1s, and whatever other information they lead to, will not go in evidence directly, but will be filtered through the minds of expert witnesses in course of preparing their testimony.

In light of the foregoing, we think a proper procedure in the premises will consist of the following elements:

A. If either party believes that use of third party renegotiation documents, not otherwise available is necessary, for discovery, trial preparation, or evidence, it shall advise the trial judge, who shall make an appropriate order. Such order shall assure that any such documents available to and used by one party, shall be available before trial to the other for similar use.

B. The said order shall include proper provision for notification of third parties, to be given by the party desiring the discovery, etc. This notice shall explain clearly the scope of FOIA access, which does not depend on the addressee's consent. (Trial Judge Miller notes in *Marinette* that several respondents seemed unaware of the extent of FOIA access and therefore they probably did not consider adequately whether the proposed discovery would inflict any injury additional to what they had already suffered.) The notice should also identify the year or years involved, and might point out the lapse of time. Of course, it should clearly identify the documents to be discovered or used. The notice should also state that in case of objection to disclosure, in full or in part, a mere letter so stating, signed by an officer of the company, and received within a specific time, will suffice, and will be taken as a tentative motion for a protective order with amplification later on being allowed if needed. (The notice in *Marinette* in several instances elicited full, formal motions for protective orders, prepared by company house counsel or Washington counsel. This probably involved unnecessary expense and inconvenience to the third parties, and may have led them to take more extreme and uncooperative positions than they otherwise would have done.) Nonresponse may be taken as acquiescence.

C. When the third parties have responded or allowed the allotted time to pass without response, the requesting party

may decide to be satisfied with the RB–1s of those who have not objected, in which case the trial judge would have no problem. If the filings of objectors are still demanded, such objectors shall be notified again and afforded a chance to formalize their objections into regular motions under Rule 71(f), to file affidavits and briefs, and in exceptional cases to make oral arguments, to which of course the parties may respond. The trial judge must balance the necessity and injury on a case by case basis, examining documents *in camera* at his discretion. An attitude of some skepticism on his part as to both necessity and injury would be appropriate, we think, with the burden of proof put on the party asserting either, and he must not forget the high regard this court has for comparison evidence. We suspect, however, that the issue now before us is much overblown: that assuming the present scope of FOIA discovery, in most cases the added material on non-renegotiable business will be neither necessary nor injurious, under all the circumstances. In general, we think a remedy by mutilating the filing in some manner other than the FOIA manner is not advisable, though we do not rule it out entirely, especially if it is the means of obtaining a stipulated settlement of the issue. Attachments to the RB–1, specified therein, are of course parts of the form, see, *e.g.* Secs. II, III, VII, VIII, and need not be discussed separately. Other material, furnished with the form voluntarily, may receive more lenient consideration. We do not think the furnishing of tax returns is really voluntary in light of line 7 and the Board procedure as we understand it, and we would discover tax returns only with great reluctance.

If any disputes arise about discovery of documents generated during and at the end of the renegotiation, what we have said can be applied by analogy.

We recognize that this procedure could impose too heavy a burden on the Trial Division. If it does, it will have to be reconsidered. We would hope the added burdens also thrown herein on the plaintiff, the defendant, and the third parties, will cause all of them to consider what their real interests are, what concessions they can afford to make, and whether

the further brewing of tempests in teapots is really advisable.

In view of the foregoing, the order under review is vacated, and the cause is remanded to the Trial Division for further proceedings consistent with this opinion.

---

546 F. 2d 365

## MARINETTE MARINE CORPORATION v. THE UNITED STATES

[No. 213–74. Decided December 15, 1976]

ON PLAINTIFF'S MOTION FOR PROMPT REVIEW

**Renegotiation of contracts; discovery; production of documents; allowable scope of discovery; Freedom of Information Act.**— Plaintiff seeks redetermination of excessive profits allegedly received during 1967, 1968 and 1969. In this phase of the litigation, the court reviews the trial judge's order of February 19, 1976 in response to plaintiff's demand for discovery of certain Renegotiation Board Forms No. 1, filed by its competitors in the shipbuilding industry. The trial judge required defendant to communicate with the third-party companies involved, and their responses included either formal motions for protective orders; objections by letter or waiver of objection; some did not respond. The objectors in several instances were apparently unaware that, except for data as to non-renegotiable business, plaintiff had access to their filings via the Freedom of Information Act. As to this aspect of the trial judge's order, *see Instrument Systems Corp.* v. *United States*, *ante* at 99, decided this day, in which it is held that third parties not before the court have a right to be notified and to be heard on a case by case basis respecting the decision as to discovery of their financial data, etc. not otherwise available under the Freedom of Information Act. Plaintiff also desired discovery of pre-award surveys and similar documents relating to award of other specified shipbuilding contracts, and also sought access to the breakdown of bid prices into their cost components as submitted by successful bidders. It is *held* that the trial judge rightly held that defendant might not produce or turn over to plaintiff any cost breakdown submitted by bidders who moved for protective orders and was not required to produce any of the others; and that as to the pre-award surveys he rightly held that defendant might not produce or turn over any that were the subject of motions or requests for protective orders. The order of the trial judge is affirmed as to result and may be followed as the basis for further proceedings in this case.

Opinion of the Court

**Renegotiation of contracts; discovery; production of documents; Freedom of Information Act.**

[1] Commitments to confidentiality express and in writing for purposes of foreclosing unauthorized administrative disclosure makes a decision difference in the Freedom of Information Act context.

Records ⟸ 14

**Renegotiation of contracts; discovery; production of documents; allowable scope.**

[2] Under this court's Rule 71(b)(1), a party may obtain discovery regarding any matter not privileged which is *relevant*. Thus, the relevance of cost breakdowns of the renegotiated contractor's competitors, in bidding on particular contracts, is dubious since it is the experienced costs and not those anticipated beforehand that are significant in the renegotiation process.

Courts ⟸ 460

**Renegotiation of contracts; discovery; production of documents; allowable scope.**

[3] In deciding that it is proper for the government not to produce or turn over to a renegotiated contractor its competitors' pre-award surveys and related papers which were the subject of the competitors' requests for protective orders, the court emphasizes that it is not holding that the turning over of such surveys is a matter wholly for the company surveyed to decide, for there may well be other legally protected interests involved and the absence of objection by the third party does not establish that the material is relevant.

Courts ⟸ 460

*William E. Bailey*, attorney of record for plaintiff, *Stewart T. Herrick*, and *Herrick, Allen, Davis, Bailey & Snyder*, of counsel.

*Peter A. T. Sartin*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before NICHOLS, KASHIWA and KUNZIG, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

In the above case the plaintiff has filed a request for prompt review, under Rule 53(c)(2)(ii), there being no certification in the record under Rule 53(c)(2)(i). Plaintiff is aggrieved by an order of Trial Judge Philip R. Miller, filed February 19, 1976. That order is much discussed in the companion case argued on the same day, *Instrument Systems Corp.* v. *United States*, *ante* at 99, 546 F. 2d 357

financial results, on an overall fiscal year basis, without reference to particular contracts that may be but a part of a fiscal year's business, and may run over two or more fiscal years.

In view of the foregoing, we think the trial judge rightly held that defendant might not produce or turn over to plaintiff any cost breakdowns submitted by bidders who moved for protective orders, and was not required to produce any of the others. As to the pre-award surveys (and related papers) he rightly held that defendant might not produce or turn over any that were the subject of motions or requests for protective orders. Whether he was right in turning over to plaintiff pre-award surveys relating to companies that had proper notice but made no motion for a protective order, may be left to be decided when we have the question before us in a proper adversary context. We do not wish to be understood as holding that the turning over of such surveys is a matter wholly for the company surveyed to decide, for there may well be other legally protected interests involved, and, of course, the absence of objection by the third party does not establish that the material is relevant.

In view of the foregoing, our decision is that the motion for prompt review is granted, but, upon review, the order of the trial judge is affirmed as to result, and may be followed as the basis for further proceedings in the case. As to his reasons, the reasons stated in the companion case, Nos. 338–73 and 339–73 (consolidated), shall be considered the reasons in this case, in the event of any conflict.

---

545 F. 2d 736

## DYNALECTRON CORPORATION v. THE UNITED STATES

[No. 230–75. Decided December 15, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; cost principles; cost-reimbursement type supply contracts; legal fees.**—Plaintiff was awarded two cost-plus award fee contracts to furnish missile tracking and support services to the Army. Plaintiff seeks to collect a portion of legal expenses which it paid defending a suit arising out of a guaranty of a commercial

Opinion of the Court

venture unconnected with said Army contracts, and which it charged to the general and administrative expenses of its entire business. The Armed Services Board of Contract Appeals held that such legal expenses were direct costs of the commercial contract and not allocable to the Army contracts in the years in issue. It is *held* that plaintiff has failed to show that the legal fees had any relationship to the Government contracts or their performance, the alleged benefit to the Government by allowing plaintiff to complete the contracts instead of going out of business being far too remote and speculative to be relevant. The decision of the Board was neither arbitrary nor capricious, is supported by substantial evidence, and is free of legal error. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Contracts; cost principles; cost-reimbursement type supply contracts; allowability and allocability of costs; legal fees re non-Government venture.**

[1] Although defense of a suit arising out of an unrelated commercial guaranty venture may have been necessary to protect plaintiff's assets, the legal expenses so incurred are not allocable, via plaintiff's general and administrative expenses of its entire business, to the subject Government contracts since they were not incurred specifically for said contracts, they did not benefit the contracts, they were not necessary to the overall operation of plaintiff's business but had a direct relationship to a particular cost objective, namely the commercial guaranty venture, nor were they incurred as an indirect cost for common or joint objectives.

United States ⇐ 70(18)

*David L. Reichardt*, attorney of record, for plaintiff.

*Gerald L. Schrader*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

In this case the plaintiff, Dynalectron Corporation, seeks review under the Wunderlich Act (41 U.S.C. §§ 321, 322) of an adverse decision of the Armed Services Board of Contract Appeals (the Board or ASBCA) in ASBCA No. 16895. Plaintiff contends that the decision of the Board contains both errors of law and findings of fact which are arbitrary, capricious, and not supported by substantial evidence. Defendant says that the decision complies with the Wunderlich Act both as to the law and the facts and should be upheld.

The case is before us on cross-motions for summary judgment. After carefully considering the pleadings, briefs, and oral argument of the parties and the record, we conclude that the decision of the Board is correct and should be affirmed.

The facts show that plaintiff was awarded two cost plus award fee contracts, No. DA-29-040-AMC-1505(5) (Contract 1505) for $15,722,796 and No. DAAD07-69-C-0032 (Contract 0032) for $37,046,082, in 1965 and 1969, respectively, by the Government for furnishing missile tracking and various other support services at the Army's White Sands Missile Range, New Mexico. These contracts contained a general provision entitled "Allowable cost, Fixed Fee and Payment," ASPR 7-203.4(a) (Sept. 1962).[1] Subparagraph (a)(i) of that clause provided for reimbursement of costs in accordance with the terms of the contract and the provisions of Part 2 of Section XV of ASPR. ASPR 15-201.2 states that among the factors affecting allowability of costs are (1) reasonableness, (2) allocability, (3) application of generally accepted accounting principles appropriate to the particular circumstances, and (4) any limitations or exclusions set forth in Part 2 of ASPR or otherwise included in the contract.

The section of ASPR that controls the decision of this case is Section XV, Part 2, which provides in pertinent part as follows:

> 15-201.4 Definition of Allocability. A cost is allocable if it is assignable or chargeable to a particular cost objective such as a contract, product, product line, process, or class of customer or activity, in accordance with the relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—
>
> (i) is incurred specifically for the contract;
>
> (ii) benefits both the contract and other work, or both Government work and other work, and can be distributed to them in reasonable proportion to the benefits received; or
>
> (iii) is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

[1] Armed Services Procurement Regulation.

15–202 Direct Costs.

(a) A direct cost is any cost which can be identified specifically with a particular cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other work of the contractor are direct costs of that work and are not to be charged to the contract directly or indirectly. When items ordinarily chargeable as indirect costs are charged to Government work as direct costs, the cost of like items applicable to other work of the contractor must be eliminated from indirect costs allocated to Government work.

(b) This definition shall be applied to all items of cost of significant amount unless the contractor demonstrates that the application of any different current practice achieves substantially the same results. Direct cost items of minor amount may be distributed as indirect costs as provided in 15–203.

15–203 Indirect Costs.

(a) An indirect cost is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost. Minor direct cost items may be considered to be indirect costs for reasons of practicality. After direct costs have been determined and charged directly to the contract or other work as appropriate, indirect costs are those remaining to be allocated to the several classes of work.

Plaintiff sues to collect a portion of $64,646 which it had paid for outside legal expenses in defending itself in a suit arising out of a commercial venture not connected with the contracts described above, which legal fees it had charged to its general and administrative expenses (G&A) of its entire business, including the above contracts. Under this procedure, plaintiff sought to require the Government to pay an allocable part of such expenses. The Government refused to pay any part of these legal fees, saying that they had nothing to do with the Government contracts and were not a proper G&A charge on the contracts.

Plaintiff became obligated to pay these legal fees in the following manner, which is described in the opinion of the D.C. Circuit Court in *Keystone Acceptance Corp.* v. *Dynalectron Corp.*, 445 F. 2d 729 (D.C. Cir. 1971). A creditor,

who was a predecessor in interest to *Keystone*, sold three airplanes to an Argentine airline, retaining a mortgage for the unpaid purchase price. The predecessor in interest to Dynalectron guaranteed that in the event of default by the purchaser, the guarantor would either return the airplanes to the creditor or pay the remaining debt. The purchaser defaulted and Keystone sued Dynalectron on its guaranty for $400,000. Dynalectron employed attorneys and defended the suit on the ground that Keystone had refused to sign the necessary papers to get the planes out of Argentina, which was a breach of the guaranty agreement. The court decided in favor of Dynalectron. The fee paid by Dynalectron to its attorneys for defending the suit is the amount in dispute here.

The plaintiff argues that the attorney fee is an indirect cost that it should be allowed to charge as a G&A expense because the defense of the lawsuit was necessary to protect its assets and this benefited the Government by allowing the plaintiff to complete the contracts instead of going out of business. We do not agree. The alleged benefit to the Government is far too remote and speculative to be relevant. We do not think there was any benefit to the Government. The facts here are distinguishable from those in our opinion in *Lockheed Aircraft Corp.* v. *United States*, 179 Ct. Cl. 545, 375 F. 2d 786 (1967) where we held that personal property taxes paid by Lockheed benefited the Government contracts involved in that case and could be allocated as costs to the contracts, because of the community services furnished with the tax money, which was beneficial to Lockheed in performing the contracts.

The Board held, and defendant contends here, that the above ASPR provisions are decisive against the plaintiff, and we agree. The costs in dispute are not allocable to the Government contracts under subparagraph (i) of ASPR 15–201.4 because they were not incurred specifically for the contracts. They are not allocable to the contracts under subparagraph (ii) because they did not benefit the contracts; and they are not allocable to the contracts under subparagraph (iii) because they were not necessary to the overall operation of the business, but had a direct relationship to a

particular cost objective, namely, the commercial guaranty venture.

The costs in question cannot be allocated to the Government contracts under ASPR 15-203(a) as an indirect cost because they were not incurred for common or joint objectives.

Finally, ASPR 15-202(a) defines a direct cost as follows:

> A direct cost is any cost which can be identified specifically with a particular cost objective.

It is clear that the costs involved here were "identified specifically" with the plaintiff's commercial venture and consequently were direct costs of that undertaking. The Board correctly decided that these legal fees were direct costs of plaintiff's commercial business and must be charged to such commercial ventures and could not be charged to the Government contracts. The Board said:

> * * * [T]hese legal costs * * * clearly fall within the definition of direct costs, chargeable either to the cost objective of the commercial guaranty contract out of which they directly arose or appellant's commercial business generally. This result is consistent with our decision in *Hastings-Raydist, Inc.*, ASBCA No. 4480, 59-2 BCA ¶ 2423, in which we held the cost of successfully defending a lawsuit arising out of the contractor's commercial work was not allocable to Government contracts.

Plaintiff cites the case of *TRW Systems Group of TRW, Inc.*, ASBCA No. 11499, 68-2 BCA ¶ 7117 in support of its argument that the legal fees in the instant case are indirect costs and can be allocated to the Government contracts. That case is distinguishable on the facts from our case. There the Board allowed expenses of a patent program, including filing and prosecution of patents, to be allocated indirectly to Government contracts. However, the facts showed that the contractor had no commercial business and was engaged solely in research and development in the space and aerospace fields for the Government. The Board held that the costs of the patent work benefited the Government. There is no such benefit to the Government in the instant case.

Plaintiff cites the case of *Hayes International Corp.*, ASBCA No. 18447, 75–1 BCA ¶ 11076 as support for allowing legal expenses to be charged as indirect costs. That case is also distinguishable from our case. There the contractor was sued for racial discrimination of its employees. The contractor had cost reimbursable contracts with the Government. The Board held that the legal fees could be charged as indirect costs to the Government contracts, as there was no showing that the employees had worked only on commercial contracts. There appeared to be a relationship between the complaint of the employees and the performance of the Government contracts. The legal fees, accordingly, were proper indirect costs of the Government contracts under ASPR 15–201.4(iii). There is no such relationship between the legal fees and the Government contracts in the instant case.

Finally, plaintiff cites the recent case of *Hirsch Tyler Co.*, ASBCA No. 20962, 76–2 BCA ¶ 12075 in support of its claim. That case is of no help to the plaintiff. In that case the contractor had a cost-reimbursement contract with the Government. During the performance the contractor was sued by an employee for sex discrimination and recovered a judgment for back pay. The question involved was whether or not the legal fees in defending the suit could be allocated as costs of the Government contract. The Board held that the costs were direct costs of the performance of the contract within the meaning of ASPR 15–202 and were allocable to the contract under ASPR 15–201.4. It is clear that in that case the costs arose out of the Government contract and had a direct relationship to the contract. There are no such facts in our case.

Plaintiff has failed to show that the legal fees had any relationship whatever to the Government contracts or their performance. Without such a relationship, the costs cannot properly be charged as direct costs or as indirect costs as a part of the G&A costs of the contractor in its performance of the Government contracts.

We conclude that the decision of the Board was neither arbitrary nor capricious, and is supported by substantial evidence. Furthermore, we find no error of law in the Board's decision.

Syllabus

The decision of the Board is affirmed. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and plaintiff's petition is dismissed.

---

546 F. 2d 367

## S.O.G. OF ARKANSAS *v.* THE UNITED STATES

[No. 4–75. Decided December 15, 1976]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; interpretation; ambiguity; compliance wtih specifications.**—Plaintiff contracted to construct on the Arkansas River a lock and dam as one unit of the larger project. The bid documents included a schematic diagram of two-stage cofferdams to be built within the existing river banks so that the lock and dam could be constructed in the dry in two successive parts. The diagram indicated that the layout was schematic and for purpose of estimating only. The specifications, which mentioned the contractor's design responsibilities, also detailed various requirements that the contractor had to meet during the two stages of river diversion and construction. After contract award plaintiff submitted its plan to divert the river beyond its banks onto its flood plain so that the river bed would be dry at one time and the lock and dam could be built in one continuous effort. The contracting officer rejected the plan for noncompliance with contract specifications. Plaintiff seeks Wunderlich Act review of a decision of the Corps of Engineers Board of Contract Appeals affirming the contracting officer's action and denying additional costs arising from the refusal to approve plaintiff's plan. Plaintiff argues that it believed the diagram was not mandatory and was for estimating only, that the specifications merely established end-performance standards, that it was free to design completely the river diversion scheme consonant with sound engineering practices and the Government's end objectives, and that its plan was feasible, economical and in compliance with a reasonable interpretation of the contract. In *confirming* the decision of the Board without deciding whether the Government's interpretation of the contract was the only or clearly the more reasonable one, the court points to the patent ambiguity in the bid documents, plaintiff's ignoring of the conflict therein, and, without seeking clarification before bidding, its assumption of the right to disregard the diagram and those parts of the specifications which would appear to limit its freedom of design. Plaintiff is not entitled to recover, its motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

---

*See order at 131 on plaintiff's motion for rehearing *en banc*.

**Contracts; interpretation; ambiguity; clarification, necessity for seeking.**

**[1] Where there is a patent ambiguity in Government bid documents, it is incumbent upon the bidders to obtain clarification from the Government by making appropriate inquiry before bidding. This principle obviates unnecessary disputes, advances the goal of informed bidding and works toward putting all the bidders on an equal plane of understanding so that bids are more likely to be truly comparable.**

United States ⇐ 70(29)

*Thomas M. Phillips*, attorney of record, and *Ronald L. Palmer*, for plaintiff. *Baker & Botts*, of counsel.

*Raymond B. Benzinger*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

This contract case, before us under the Wunderlich Act, 41 U.S.C. §§ 321–22, arose from plaintiff S.O.G. of Arkansas' agreement to construct Lock and Dam No. 4 on the Arkansas River. The project, one unit of a system of seventeen locks and dams, was designed to help provide a navigable channel from the Mississippi River to Catoosa, Oklahoma. S.O.G., a joint venture formed to obtain and perform the contract, responded to a Corps of Engineers' invitation for bid (IFB) issued in October 1974. The Government's bid documents included a schematic diagram of cofferdams to be constructed of steel sheet piling cells in the river areas and embankment dikes on the existing river banks. This plan unmistakably indicated that the cofferdams were to be built within the existing river banks, and that the purpose was to permit, first, one-half of the lock and dam construction to be built "in the dry," and then the other half. On the face of the diagram was a notation stating that the diagram was "schematic and for the purpose of estimating only." Accompanying the diagram were detailed specifications that outlined various requirements that the contractor had to meet during the two stages of river diversion and construction. The notation on the diagram also stated that "[d]esign of the diversion scheme will

be in accordance with the applicable provisions of the specifications."

S.O.G. and its engineering consulting firm reviewed the plans and specifications and devised what they considered to be the best plan for diverting the river during construction. S.O.G.'s scheme diverted the river beyond its banks onto its flood plain, so that the entire river bed would be dry at one time and the lock and dam could be built in one continuous effort; unlike the plan indicated on the Government's diagram, S.O.G's arrangement did not confine the diversion within the natural channel of the river, nor did it provide that part of the river would at all times be flowing in its normal channel.[1] S.O.G. says that it based its bid on its own plan, believing that the diagram provided in the bid documents was in no way mandatory and that plaintiff's plan was feasible, economical and in compliance with a reasonable interpretation of the plans and specifications.

After the Government awarded the contract to S.O.G., plaintiff submitted its diversion plan for the Corps' approval. The Government thoroughly considered S.O.G.'s plan over a period of three weeks. Although subordinates of the contracting officer thought that the plan could be implemented if a number of modifications were made, the contracting officer eventually rejected it on the ground that it did not comply with the contract specifications. S.O.G. was thereafter required to implement the river diversion plan depicted on the contract diagram, causing plaintiff (it asserts) to incur $2,000,000 in additional expenses.

S.O.G. contends that the Government's diagram was in no way binding since it was designated as "schematic and for the purpose of estimating only." As for the specifications, they were thought to be merely general criteria establishing end-performance standards; accordingly, plaintiff

[1] Also, S.O.G. proposed a single earthen cofferdam, not two steel cofferdams. Plaintiff's brief (pp. 3–4) says that the Engineers' plan "was much more expensive to implement than the S.O.G. Diversion Plan. Specifically, it required diverting the Arkansas River in two steps utilizing two successive cofferdams and building the permanent structures in two separate steps rather than one continuous operation as contemplated by the S.O.G. Plan. Also, the Plan depicted on the [IFB] Drawing showed the use of steel sheet piling in the two cofferdams as opposed to the earthern cofferdam that S.O.G. anticipated using."

says it was free to design completely the river diversion scheme as long as its plan followed sound engineering and construction practices and accomplished the Government's essential end-objectives. To support its position, S.O.G. relies on several paragraphs of the specifications concerning the contractor's design responsibilities and holding the contractor liable for the success of the diversion plan. The Government, however, urges that the diagram and specifications clearly called for the use of cofferdams and a two-stage diversion and construction scheme within the river banks. While the contractor was to have certain design responsibilities (and accompanying liability for a design failure), the Government asserts that the contract documents did not give S.O.G. the right to disregard the Government's basic river diversion plan and substitute a very different one which was admittedly not confined within the river's banks. The Government therefore asserts that it properly rejected S.O.G.'s diversion plan and insisted on its own.[2]

In order to resolve this dispute, we need not agree with either party's interpretation of the contract. The case presents another example of a contractor who, faced with a patent ambiguity in Government bid documents, did not meet his responsibility to have the ambiguity resolved before bidding. *See, e.g., Space Corp.* v. *United States*, 200 Ct. Cl. 1, 5–6, 470 F. 2d 536, 538–39 (1972); *Jamsar, Inc.* v. *United States*, 194 Ct. Cl. 819, 827, 442 F. 2d 930, 934 (1971); *Woodcrest Constr. Co.* v. *United States*, 187 Ct. Cl. 249, 260, 408 F. 2d 406, 412–13, *cert. denied*, 398 U.S. 958 (1970); *J. A. Jones Constr. Co.* v. *United States*, 184 Ct. Cl. 1, 12–13, 395 F. 2d 783, 789–90 (1968); *Blount Bros. Constr. Co.* v. *United States*, 171 Ct. Cl. 478, 496, 346 F. 2d 962, 972–73 (1965); *Beacon Constr. Co. of Mass.* v. *United States*, 161 Ct. Cl. 1, 6–7, 314 F. 2d 501, 503–04 (1963). We therefore confirm the decision of the Corps of Engineers Board of

[2] The Government's position is supported, at least to some extent, by *S. S. Mullen, Inc. and Dravo Corp.*, Eng. BCA No. 3241 (7 April 1972), *aff'd sub nom S. S. Mullen, Inc. & Dravo Corp., d/b/a Juneau Dam Constructors*, 203 Ct. Cl. 750 (1974). In that case the Board held that a schematic drawing which showed an access road on one side of a river could not be interpreted to allow the contractor to build the road on the river's other side even though the specifications stated that the alignment shown on the diagram was schematic and that the contractor was responsible for determining alignment and road design.

Contract Appeals without having to decide, as the Board did, whether the Government's interpretation of the contract was the only, or clearly the more, reasonable one.

From the contractor's point of view, there was obviously a patent ambiguity in the IFB documents. Plaintiff itself says in its reply brief (p. 2) that an "important and salient point" is that "the contract documents in this case are subject to at least two reasonable interpretations; the one made by S.O.G. in proposing its Diversion Plan (which is the basis of its claim for equitable adjustment) and the one argued for by the Government in its Brief (which the Government contends is the only reasonable interpretation)." There is no doubt that the bid documents contain significant expressions favoring each side. On the one hand, the defendant can point to the contract diagram which was utterly irreconcilable with plaintiff's scheme. If the diagram itself could be entirely disregarded (because of the legend that it was "schematic" and "for the purpose of estimation only") then there were specific parts of the specifications which appeared to implement the general plan of the diagram and were very hard to harmonize with plaintiff's position.[3] On the other hand, plaintiff relies primarily on the diagram's legend and the absence of any statement that the diagram plan was mandatory; on the references in the specifications to the contractor's responsibility for the "design" of cofferdam and dewatering "systems" as well as to the contractor's "proposed diversion plan"; and on the explicit and unqualified statement that the contractor would be responsible "for the adequacy of the plan."

[3] Paragraph 1–02 ("Diversion Structures") provided: "* * * Construction of the cofferdams *within the river banks* shall not commence until the *protective left bank revetment* has been completed. Except for those portions of the cofferdams *on the existing river banks* which may be embankment dikes, cofferdams enclosing the work area shall be constructed of new or used interconnected steel sheet piling cells * * *. *Stage construction of cofferdams* shall be so laid out and scheduled that *at all times during the first stage and any intermediate stages of diversion* there will be a minimum clear river opening of 550 feet at elevation 189.0. *The completed lock and the first seven completed spillway bays shall be available for river flow during the last stage of river diversion* * * *." (Emphasis added.)

Paragraph 1–03 ("Design Data") provided that "The plan for diversion of the river flow * * * has been prepared by the Government for the use of the contractor and is shown on the drawings," and expressly refers to two stages of cofferdam construction and to "upstream" and "downstream" portions.

(Continued)

We cannot escape the conclusion that a knowledgeable bidder, as S.O.G. admittedly was, should have recognized at once that there would be a grave problem as to whether its proposed diversion plan conformed with the IFB. Those documents appeared on their very surface to be internally inconsistent on the important point of the diversion plan; the contradiction was not subtle, hidden, or minor but patent, blatant, and significant. Indeed, the record suggests that S.O.G. was in fact aware of the problem. After bid opening but before the award, representatives of the plaintiff met to discuss the diversion and considered alternate plans, including the Corps' two-stage within-banks plan as depicted on the diagram, which admittedly was much more expensive than the plan S.O.G. ultimately submitted. It was anticipated that the Corps might reject the plaintiff's own plan. And at the conference (after award) at which the contracting officer definitely rejected plaintiff's scheme, its principal officer agreed that he had taken a calculated risk in submitting his proposed plan.

Rather than ask for clarification, and despite the warning given it by the bid documents, S.O.G. ignored the conflict inherent in these documents and assumed the right to disregard the diagram and those parts of the specifications that would appear to limit its freedom of design. The extra expenses which S.O.G. now claims may well have been covered if, prior to bidding, S.O.G. had acted to clarify its responsibilities under the contract. If it had inquired and discovered what the Government wanted it may not have bid on the project or, if it decided to bid, it may have been able to tailor more advantageously its design and the concomitant costs. S.O.G. acted without seeking to resolve this patent ambiguity, and while the plan it submitted may have been as reasonable as the one proposed by the Government, under the circumstances the latter had the right to reject a scheme not in accordance with its conception of the project.

(Continued)
Paragraph 1–04 ("Submission of Plan of Diversion for Approval") required the contractor to submit a diversion plan (after notice to proceed) which, among several other things, would give the "details of the tie-in between Stage II cofferdam and permanent construction." Paragraph 1–11 ("Removal of Cofferdam") declared: "Stage I cofferdam shall be removed concurrently with construction of Stage II cofferdam and shall be completely removed prior to or upon completion of Stage II cofferdam * * *. After Stage II cofferdam has served its purpose, it shall be removed as required."

On Motion for Rehearing

The rule that a contractor, before bidding, should attempt to have the Government resolve a patent ambiguity in the contract's terms is a major device of preventive hygiene; it is designed to avoid just such post-award disputes as this by encouraging contractors to seek clarification before anyone is legally bound. The rule is the counterpart of the canon in government procurement that an ambiguous contract, where the ambiguity is not open or glaring, is read against the Government (if it is the author). *See Sturm* v. *United States*, 190 Ct. Cl. 691, 697, 421 F. 2d 723, 727 (1970). Both rules have their place and their function. In addition to its role in obviating unnecessary disputes, the patent-ambiguity principle advances the goal of informed bidding and works toward putting all the bidders on an equal plane of understanding so that the bids are more likely to be truly comparable. Conversely, the principle also tends to deter a bidder, who knows (or should know) of a serious problem in interpretation, from consciously taking the award with a lower bid (based on the less costly reading) with the expectation that he will then be able to cry "change" or "extra" if the procuring officials take the other view after the contract is made.

For these reasons, plaintiff's motion for summary judgment is denied and the defendant's motion is granted. The petition is dismissed.

---

ON PLAINTIFF'S MOTION FOR REHEARING EN BANC PURSUANT TO RULES 7(d) AND 151(b)

[March 4, 1977]

ORDER

*Thomas M. Phillips*, attorney of record, and *Ronald L. Palmer*, for plaintiff. *Baker & Botts*, of counsel

*Raymond B. Benzinger*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

---

Before DAVIS, *Judge*, Presiding, COWEN, *Senior Judge*, and BENNETT, *Judge*.

On Motion for Rehearing

This case comes before the court on plaintiff's motion, filed January 21, 1977, for rehearing *en banc* pursuant to Rules 7(d) and 151(b), requesting that the court reconsider its opinion and decision of December 15, 1976, dismissing plaintiff's petition. The motion has been considered without oral argument.

As for the suggestion for rehearing *en banc* under Rule 7(d), the matter was considered by the then seven active Judges of the court (Chief Judge Cowen not having yet taken senior status at the time the vote was taken) and was denied.

The motion for rehearing under Rule 151(b) has been considered by the panel listed above. Plaintiff claims that the basis of the court's decision—application to this case of the principle of "patent ambiguity"—was an unfair surprise to it, not having been previously raised in the litigation. The panel points out, however, that, although the defendant did not base an extended argument on the so-called rule of "patent ambiguity", that principle was plainly adverted to in at least two separate places in the Government's main brief filed November 28, 1975.[1] The plaintiff should not have been taken by surprise. Moreover, assuming contrary to fact that the defendant had never mentioned the contention at all, it is important that the principle of "patent ambiguity" was expressly raised from the bench during oral argument; our rule has been that where a new subject is brought into the case by questions from the bench at oral argument, a party which feels that the record or briefing, as they stand, inadequately present its position on that matter should so inform the court at the argument or promptly thereafter. In that situation it is not proper practice to wait, as here, until after the decision to make that claim. *General Electric Co.* v.

[1] At page 39 of that brief, the defendant emphasized certain provisions of the specifications which (in the defendant's view) plaintiff's proffered plan could not meet—and then added significantly: *"At the least, the emphasized language should have been a signal to plaintiff that it would have to seek clarification of the conflicts between the specifications and its intended diversion plan."* (emphasis added).

*See also* the following at page 46 of the brief:

> "Plaintiff, at page 42 of its brief asks: 'How in the world is the contractor supposed to know what parts of the –353 he can disregard . . .?' The short answer is that if provisions appear to be ambiguous a reasonable interpretation will disregard nothing. *The simple answer to the question is that the contractor has a duty to inquire when provisions are in conflict."* (emphasis added)

Syllabus

*United States*, 189 Ct. Cl. 116, 117–18, 416 F. 2d 1320, 1321–22 (1969). This *General Electric* rule has often been applied by this court.

Even as a general matter it should not have been surprising that the principle of "patent ambiguity" was considered by the court to be implicated in this case. The interpretation of plaintiff's contract presented an issue of law on which the court was not bound by the decision of the Board of Contract Appeals. In particular, the court was not restricted to choosing between the contentions that plaintiff's interpretation of the contract had to be accepted because it was at least reasonable and the contrary argument that plaintiff's interpretation had to be rejected because it was not at all reasonable. It could and should have been foreseen by the parties that included and embraced within those polar antitheses was the middle possibility that, though plaintiff's position might be reasonable in itself, it rested on contract documents which contained patent ambiguities calling for clarification.

IT IS THEREFORE ORDERED that plaintiff's motion for rehearing be and the same is denied.

---

545 F. 2d 1286

## PENINSULA MOTOR CLUB v. THE UNITED STATES

[No. 385–75. Decided December 15, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Taxes; accounting methods; prepaid club dues income.**—Taxpayer, an automobile service club, qualified and elected to be treated as a "membership organization" within the meaning of Sec. 456 of the Internal Revenue Code of 1954. During taxable years 1970 and 1971 plaintiff charged each new "Master Member" $25 for the first year and $18 for each renewal year, and "Associate Members" $12.50 for the first year and $9.00 for each renewal year. Services performed for a new member and for a renewal member were the same. The Internal Revenue Service determined that the $7.00 difference between the first year charge and the renewal charge for "Master Members" and the $3.50 difference for "Associate Members" did not constitute "prepaid dues income" within the meaning of Sec. 456. Therefore, the Service included these additional charges as income in the years in which they were received, rather than permitting plaintiff

Syllabus

to defer portions thereof as it had done theretofore. The effect of including these amounts in income for 1970 and 1971 was to increase plaintiff's income, to decrease its net operating losses for those years, and to correspondingly reduce its operating loss carrybacks to 1968. Upon denial of plaintiff's administrative claim for refund of the additional taxes it was assessed and paid for 1968, plus statutory interest, plaintiff filed the present suit. It is *held* that plaintiff has shown that the entire amount of dues which it received from its first year members during the years in suit constituted "prepaid dues income" within the meaning of Sec. 456, and is entitled to a refund of the assessments for 1968. Defendant's motion for summary judgment is denied, plaintiff's cross-motion is granted, and judgment is entered for plaintiff for $62,766.27, plus statutory interest.

**Taxes; revenue laws; construction and operation; legislative intent; prepaid dues income.**

[1] In enacting Sec. 456 of the Internal Revnue Code of 1954, it was the express intent of Congress to overrule *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180 (1957), and *American Automobile Ass'n.* v. *United States*, 367 U.S. 687 (1961).

Internal Revenue ⇐ 261

**Taxes; accounting methods; prepaid club dues.**

[2] Where plaintiff club qualifies as a "membership organization" within the meaning of Sec. 456 of the Code, it is entitled to prorate club dues without showing more than a general correlation between the dues and the period in which membership services are performed. The "prepaid dues income" language of said section is broad enough to encompass additional membership fees charged to first year members representing payment of salesmen's commissions since the commissions are an essential element of the club's liability under Sec. 456(e)(2) to provide membership privileges to new members.

Internal Revenue ⇐ 264

**Taxes; accounting methods; prepaid club dues income v. initiation fee.**

[3] The "prepaid dues income" concept of Sec. 456 is different from the dues-initiation fee dichotomy which appeared in Sec. 4242, now repealed.

Internal Revenue ⇐ 264

*Stanley W. Rosenkranz*, attorney of record, for plaintiff. *Charles E. Auslander*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

---

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

Opinion of the Court

COWEN, *Chief Judge*, delivered the opinion of the court:

Plaintiff, Peninsula Motor Club (Peninsula), brings this action for the recovery of income taxes and accompanying interest paid for the taxable year ended December 31, 1968. Upon audit by the Internal Revenue Service, plaintiff's income for its 1970 and 1971 taxable years was increased and its net operating losses for those years decreased, such that plaintiff's operating loss carrybacks to 1968, under section 172 of the Internal Revenue Code were reduced. As a result, additional income taxes of $51,183.22, plus statutory interest of $11,583.05 were assessed against plaintiff for the taxable year 1968. The total amount of the additional assessment was $62,766.27, which was paid about October 23, 1974. Plaintiff filed a timely claim for refund and thereafter instituted this action.

Peninsula is a Florida corporation formed in 1936. As an automobile club, it provides the following services to both its first-year and renewal members: (1) 24-hour nationwide emergency road service; (2) bail bonds for minor traffic violations and reimbursement for some legal fees; (3) Film "Club" and Mailing Service, automobile license procurement, a monthly newspaper and fully warranted tires and batteries. For tax purposes, plaintiff is considered a "membership organization" within the meaning of section 456(e) of the Internal Reveue Code, in that it (1) is "organized without capital stock of any kind," and (2) distributes no part of its net earnings to any member. I.R.C. § 456(e)(3)(A–B).

Since plaintiff qualifies for and has elected to be treated as a "membership organization" within the meaning of section 456, it is entitled to report membership dues received as "prepaid dues income" and to spread the income ratably over the period in which membership services are provided, rather than reporting such income in the year received.

Plaintiff has two categories of membership—"Associate" and "Master" members. During the taxable years 1970 and 1971, it charged each new "Master Member" $25 for the first year and $18 for each renewal year. "Associate Members"

were charged $12.50 for the first year and $9 for each renewal year. There is no difference whatever between the services plaintiff provided for a first year member and for a renewal member in his category.[1]

The Internal Revenue Service determined that the $7 difference between the first year charge and the renewal charge for "Master Members" and the similar $3.50 difference for "Associate Members" did not constitute "prepaid dues income" within the meaning of section 456. Therefore, the Service included these additional charges as income in the year in which plaintiff received them, rather than permitting the taxpayer to defer portions of such income under section 456 as it had done for many previous years. The result was the additional assessment for which plaintiff seeks recovery in this action.

Plaintiff's bylaws recognize a difference between first year membership dues and renewal (annual) dues in the manner in which dues are paid and in the manner in which dues are fixed by its Board of Directors. However, plaintiff has no provision in its bylaws, applications for membership, or sales brochures which refers to an "initiation fee" or which describes the higher first year payments as anything other than as "dues." If, for any reason, Peninsula cancels or refunds a portion of the first year membership fee, it returns a chronologically ratable portion of the entire $25 or $12.50 dues, and does not carve out and retain any portion of the payment for an initiation fee.

Peninsula justifies its higher dues for the first year members on the ground that first year members cost the club more than renewal members. Plaintiff's records indicate that it experienced the following costs with respect to each first year membership:

---

[1] There is, furthermore, no difference in the services provided "Master" and "Associate" members. However, "Associate" memberships are available only to the spouse or dependent minor children of a "Master" member. *See* Plaintiff's Brief, p. 13.

| | *Master* | *Associate* |
|---|---|---|
| Commissions | $10.00 | $5.00 |
| Bonuses to Salesmen | 4.00 | 2.00 |
| AAA (national) dues | .25 | .25 |
| Accident Policies | 1.40 | 1.40 |
| Road Services | 2.36 | 2.36 |
| Maps and Supplies | .69 | .69 |
| Florida Explorer | .22 | .22 |
| Administrative Cost | 7.60 | 7.60 |
| Total | $26.52 | $19.52 |

It experienced the following costs with respect to each renewal membership:

| | *Master* | *Associate* |
|---|---|---|
| Commissions | $5.00 | $2.50 |
| Bonuses to Salesmen | ------ | ------ |
| AAA (national) dues | .25 | .25 |
| Accident Policies | 1.40 | 1.40 |
| Road Services | 2.36 | 2.36 |
| Maps and Supplies | .69 | .69 |
| Florida Explorer | .22 | .22 |
| Administrative Cost | 7.60 | 7.60 |
| Total | $17.52 | $15.02 |

The issue before the court is a narrow one, more limited in scope than questions of deductions or exemptions applicable to tax-exempt organizations. We are here concerned only with determining when admittedly taxable income should be taken into account for tax purposes and reported in the returns of a taxpayer, which is a "membership organization" within the purview of section 456 of the Code.

Section 456 provides that "membership organizations" may prorate, over the life of the membership period, any "prepaid dues income" received from the members. "Prepaid dues income" is defined in Internal Revenue Code section 456(e)(1) as follows:

> * * * any amount (includible in gross income) which is received by a membership organization in connection with, and is directly attributable to, a liability to render services or make available membership privileges over a period of time which extends beyond the close of the taxable year in which such amount is received.

The only question before the court is whether the additional membership fees charged to first year members should be considered "prepaid dues income."

The Government advances two closely related arguments in support of its position that the additional first year charges should not be so treated and therefore, should be reported in the year received. Both these arguments concern the extent of equivalence which must be shown between the dues charged and the services rendered in return.

The first argument centers about the *timing* of the dues and benefits, it being the Government's position the taxpayer cannot prevail, because the salesmen's commissions are incurred only "at the outset of membership" and not "over the membership period." The second argument concerns the *amount* of dues and benefits. The Government maintains that since new members pay more in dues, but receive the same services as renewal members, the additional first year charges are more "in the nature" of an "enrollment fee" or an "initiation" charge. The premise underlying these arguments is that unless there is a very close correspondence—a matching between membership dues income and expenses incurred in behalf of members—the dues are not "directly attributable" to the privileges and cannot be considered prepaid dues income.

We disagree with the Government's premise and think that the legislative history of section 456 negates both of the Government's contentions. Section 456 was added to the Internal Revenue Code in 1961, after the Supreme Court's decision in *Automobile Club of Michigan* v. *Commissioner*, 353 U.S. 180 (1957). In that and subsequent decisions, the Supreme Court required a club to show that membership dues closely correlated to the period over which membership privileges were provided before the club could prorate its dues. *See also American Automobile Association* v. *United States*, 367 U.S. 687 (1961).

When Congress subsequently passed section 456, it did so with the express intent of overruling the Supreme Court's decisions. This intent of Congress was shown in the report of the House Ways and Means Committee, H. Rep. No. 381, 87th Cong., 1st Sess.; 1961–2 Cum. Bull. 390, 391:

Opinion of the Court

The problem with which this bill is concerned is substantially similar to the problem dealt with in the case of the prepaid subscription income provision enacted in 1958. In *Automobile Club of Michigan* v. *Commissioner* (*353 U.S. 180*) * * * in 1957, the Supreme Court held that membership dues received one year in advance by that automobile club must be reported for income tax purposes for the year of receipt rather than over the 12-month period to which the dues related. The 1939 Code (and also the 1954 Code) provides that income is to be computed in accordance with the method of accounting regularly employed by the taxpayer in keeping his books, unless this method does not clearly reflect income. The Supreme Court denied this automobile club the right to spread the income over the period to which the dues related *primarily on the grounds that the services which the club must render for the member might not be spread in the same manner as a pro rata allocation of the club dues.*

The pro rata allocation of annual membership dues over the 12 months to which the dues relate *may not precisely match the periods in which services are performed for individual members. Nevertheless,* your committee believes that spreading dues income of these clubs in this manner will *more clearly approximate* the period in which the services are rendered than reporting the income for the year of the receipt of the membership dues.

To more accurately reflect generally accepted accounting principles in this case, therefore, your committee has concluded that in the case of membership dues it is desirable to provide in the code (sec. 456) that this income, subject to certain restrictions, may at the election of the taxpayer be reported on a pro rata basis over the period to which the income relates, that is, over the period in which the services to which the dues relate are required to be performed. [Emphasis added.]

We think it sufficiently clear from the above language that Congress passed section 456 specifically to permit a club to prorate dues without showing more than a general correlation between the dues and the period in which membership services are performed. Moreover, we think there are additional factors which warranted plaintiff's treatment of the additional first year charges as "prepaid dues income." In the first place, the requirement of a perfect correlation between the amount of dues and the cost of services actually received

by any members would produce unworkable and perhaps absurd results. Membership organizations which operated under such a requirement would be faced with the almost impossible task of proving that any member's dues exactly covered the cost of the privileges he received. Clubs with older or nonresident members paying lower dues would be faced with extremely difficult tax accounting and reporting problems. Possibly, the Internal Revenue Service would have to audit virtually every membership organization which sought to defer dues under section 456. Surely Congress did not intend such a result when it enacted section 456.

In the second place, the language of section 456 itself appears broad enough to encompass the additional fees, required to pay salesmen's commissions within the concept of "prepaid dues income." Section 456(e)(2) of the Code, defines liability, referred to in section 456(a) as follows:

> The term "liability" means a liability to render services or make available membership privileges over a period of time which does not exceed 36 months, which liability shall be deemed to exist ratably over the period of time that such services are required to be rendered, or that such membership privileges are required to be made available.

It is undisputed that the cost incurred by plaintiff in obtaining new members was considerably higher than the cost of its renewal membership. When it accepted the dues received from new members, there is no doubt that it became liable to "make available membership privileges" to them over a period of 12 months. Furthermore, commissions paid to salesmen are an essential element of plaintiff's liability to provide membership privileges to new members. In view of the liberal relationship which Congress sanctioned with respect to the period in which the dues are received and the period in which membership services are provided, we find that commissions and bonuses paid to salesmen are integrally related to the club's efforts to "make membership privileges available."

In the third place, we find that defendant's position is inherently inconsistent. The Government objects to the differences in costs but challenges only the differences in membership fees. Were the Government's challenges consistent with its objections, it would not permit plaintiff to defer the

actual difference between the sales costs for new and renewal members. This was $9 for Master members and $4.50 for Associate members. Similarly, plaintiff would be required to deduct from its prepaid dues income the costs of commissions paid to salesmen on renewal memberships. Commissions paid by plaintiff on each renewal membership amounted to $5 per year for Master members and $2.50 per year for Associate members.

In support of its contention that the plaintiff's additional charge for first year memberships constituted an "initiation fee" rather than "dues," defendant relies on a distinction between "dues" and "initiation fees" as defined in former sections of the Code—sections 4242 (a) and (b). Section 4242, which was repealed in 1965 (Pub. L. 89-44, 79 Stat. 145), defined dues for social, athletic and sporting clubs, whose exemption from tax depends upon their being solely supported by membership fees. See Treas. Reg. § 1.501(c)(7)-1(a). The repealed section is not relevant to questions concerning "membership organizations" such as plaintiff, a nonexempt taxpayer whose income is taxable in any event.

Section 456 speaks only of "prepaid dues income," a specifically defined concept which is quite different from the dues-initiation fee dichotomy which appeared in section 4242. The several cases cited by the Government concerning initiation fees are consequently irrelevant and inapplicable. *See, e.g., Knollwood Club* v. *United States*, 74 Ct. Cl. 1, 48 F. 2d 971 (1931).

CONCLUSION

On the basis of the facts which are not in dispute, we conclude that plaintiff has shown that the entire amount of dues which it received from its first year members during the years in suit constituted "prepaid dues income" within the meaning of section 456, and that plaintiff is entitled to a refund of the additional taxes assessed and paid as a result of the determination to the contrary by the Internal Revenue Service.

Accordingly, defendant's motion for summary judgment is denied; plaintiff's cross-motion for summary judgment is granted, and judgment is hereby rendered in favor of plaintiff for the sum of $62,766.27, plus statutory interest thereon.

Syllabus

546 F. 2d 371

# PHILIP B. LINDY, TRADING AS FOUNTAIN VIEW APARTMENTS v. THE UNITED STATES

[No. 101–75. Decided December 15, 1976]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Federal housing; National (Federal) Housing Act; premium, appraisal and inspection charges; refund of fee.**—Plaintiff seeks to recover an inspection fee which he paid pursuant to 12 U.S.C. § 1713 (d) to the Department of Housing and Urban Development (HUD). Plaintiff was unable to commence construction of the federally insured project and defaulted on the mortgage. The mortgage was assigned to HUD which sued in a federal district court to foreclose on plaintiff's property. The court entered a foreclosure decree, and also dismissed plaintiff's counterclaim for the amount of the inspection fee without prejudice to having the claim asserted in a proper proceeding. Defendant refused to refund the fee in the belief that the district court's dismissal order was *res judicata*. It is *held* that since the reason for refusal of the refund was legally erroneous and since there had been no inspection or construction although the fee was collected for purpose of inspection of property during construction, the refusal to refund was an abuse of the discretion vested in HUD. Plaintiff is entitled to recover the entire fee. Defendant's motion for summary judgment is denied, plaintiff's cross-motion is granted, and judgment is entered for plaintiff for $17,327.

**Federal housing; National (Federal) Housing Act; premium, appraisal and inspection charges; refund of fee.**

[1] It is within the discretion of the Commissioner of FHA to refund an inspection fee authorized under 12 U.S.C. § 1713(d) in connection with appraisal of property offered for FHA insurance of a mortgage and for inspection of the property, and retention of the fee does not give rise to a right to recover it unless refusal reflects an abuse of discretion.

United States ⇐ 53(9)

**Judgments; former adjudication; judgment not on merits.**

[2] A claim not ruled on, but dismissed without prejudice to renew in a proper proceeding, is not *res judicata*.

Judgment ⇐ 565

**Federal housing; National (Federal) Housing Act; premium, appraisal and inspection charges; authority of Commissioner to retain fees; abuse of discretion.**

[3] Where the general counsel of HUD denied plaintiff's claim for refund of an inspection fee for the reason that a district court's judgment for defendant foreclosing on plaintiff's property was *res*

Opinion of the Court

*judicata*, although the court dismissed plaintiff's counterclaim for refund of the fee without prejudice to having the claim asserted in a proper proceeding, counsel's refusal to refund was an abuse of discretion since the reason therefore was legally erroneous and further there had been no property inspection for which the fee was collected.

United States ⚖ 53(9)

*Victor Wright*, attorney of record, for plaintiff. *Fox, Rothschild, O'Brien & Frankel*, of counsel.

*Arlene Fine*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This suit for refund of an FHA inspection fee comes before the court on defendant's motion and plaintiff's cross-motion for summary judgment. A provision of the National Housing Act of 1934, as amended and printed at 12 U.S.C. § 1713(d) (1970), reads in part: "* * * [T]he Secretary [of HUD] is authorized to charge and collect such amounts as he may deem reasonable for the appraisal of a property or project offered for insurance [*i.e.*, FHA insurance of the mortgage] and for the inspection of such property or project during construction * * *." A regulation promulgated thereunder, relating to the inspection charge or fee, is the sole statement in the statutes and regulations dealing with the refund of the fee. It provides, "[c]ommitment, inspection, and reopening fees may be refunded in whole or in part, if it is determined by the Commissioner [of FHA—now a part of HUD] that there is a lack of need for the housing or that the construction or financing of the project has been prevented because of condemnation proceedings or other legal action taken by a governmental body or public agency, or in such other circumstances as the Commissioner may determine." 24 C.F.R. § 221.507 (1972).

Plaintiff, a Philadelphia area contractor hoping to build the Fountain View Apartments, paid HUD the inspection fee mentioned in the above statute covering the project

plaintiff was intending to undertake, pursuant to FHA regulations and the mortgage loan agreement. Plaintiff made the payment, $17,327, in October 1972, out of funds advanced him by his mortgagee, Metropolitan Federal Savings of Philadelphia. HUD sent inspectors to the proposed construction site, once in November 1972, and once again in February 1973, who were able to report only that construction had not yet begun. The answer to the petition, paragraph 9, admits that "no inspection of the project occurred." Plaintiff never was able to commence construction on his apartment building, and ultimately defaulted on the mortgage. HUD paid Metropolitan pursuant to the insurance arrangements, was assigned the mortgage, and sued in the federal district court in Philadelphia to foreclose on plaintiff's property. The district court entered the requested foreclosure decree in December 1974. At the same time, the court dismissed plaintiff's counterclaim in the full amount of the inspection fee without prejudice to having the claim asserted again in a proper proceeding—the Court of Claims was specifically mentioned in the court's order—as the court apparently recognized its jurisdictional limitations. On February 25, 1975, the general counsel of HUD responded to plaintiff's attorneys' letter of January 29, 1975, denying the latter's claim for a refund of the $17,327 inspection fee. The general counsel's words, though few, are critical to the disposition of this claim, and therefore worth quoting:

> On December 11, 1974, Judge VanArtsdalen handed down his decision dismissing Mr. Lindy's claim and granting the government's motion for summary judgment. Therefore, we deem the claim to be res adjudicata.

This suit followed on April 3, 1975.

Plaintiff says that HUD abused its discretion under 24 C.F.R. § 221.507 when it refused plaintiff's request for a refund of the entire fee. Defendant relies heavily upon *D & L Constr. Co.* v. *United States*, 180 Ct. Cl. 366, 378 F. 2d 675 (1967), *Terminal Constr. Corp.* v. *United States*, 171 Ct. Cl. 1 (1965), and *Heers* v. *United States*, 165 Ct. Cl. 294, 357 F. 2d 344 (1964), to support its view that refund is within the sound discretion of HUD and not called for here. The *Heers* case involved a $17,000 FHA mortgage insurance application

fee which a regulation said "may be returned to the applicant" if "an application is rejected before it is assigned for processing by the Commissioner, or in such other instances as the Commissioner may determine." On the basis of this regulation, this court found that the purpose of the application fee was to cover expenses of processing the application for insurance, and that refund was within the Commissioner's sound discretion. This did not mean that a refusal to return a fee was always justified, but rather that "plaintiff is not entitled to its return unless it appears that the refusal reflects an abuse of discretion." 165 Ct. Cl. at 311, 357 F. 2d at 354. *Terminal* and *D & L* are to the same effect. *Cf. D & L Constr. Co.* v. *United States*, 180 Ct. Cl. 436, 446, 378 F. 2d 680, 686 (1967).

In that the statute and regulation in these three cases parallel section 1713(d) and section 221.507, they arguably support defendant's view that refund is committed to HUD's discretion. The three cases do not, however, show that HUD did not abuse its discretion here. The cases say little about what constitutes an abuse of discretion in the refund area for they all turn on failures of proof by the plaintiffs. It resolves nothing to assert that section 221.507 permits HUD to decide when it will make a refund, or whether it will make one where stated conditions (*e.g.*, lack of a need for housing) have come to pass, for every exercise of discretion that is reviewable and not committed by law to agency judgment alone exists within the limits of reason.

Plaintiff centers his abuse-of-discretion complaint on the fact that the HUD general counsel based the refund refusal on the belief that the district court's dismissal order was *res adjudicata*. This complaint is well taken for the general counsel's response was plainly erroneous. It is elementary that a claim not ruled on, but dismissed without prejudice to renew in a proper forum, is not *res adjudicata*. *Smith* v. *McNeal*, 109 U.S. 426 (1883); *American Guaranty Corp.* v. *United States*, 185 Ct. Cl. 502, 401 F. 2d 1004 (1968). Whether the general counsel's statement is viewed as a patently incorrect exercise of discretion, or as a failure to exercise discretion at all, its content and the refusal to refund flowing from it amount to an abuse of the discretion vested in HUD,

Syllabus

acting on behalf of the Commissioner of FHA, by section 221.507. Here a statute has authorized collection of a fee for the purpose of "inspection of such property * * * during construction." It is admitted that there was neither inspection nor construction. Moneys collected therefor have been retained either for a legally void reason or for what is evidently no reason whatever. The result compelled by HUD's conduct is necessarily the refund of the entire inspection fee. *Terminal Constr. Corp.* v. *United States*, *supra*; *Heers* v. *United States*, *supra*.

In view of this disposition of the case, we need not rule on plaintiff's alternate contention that it is entitled to judgment because of the failure of section 1713(d) to provide for HUD's retention of the inspection fee. Defendant's motion for summary judgment is denied, plaintiff's cross-motion is granted, and judgment is entered for plaintiff in the amount of $17,327.

---

546 F. 2d 373

## GEORGE W. HIGGS, ET AL. v. THE UNITED STATES

[No. 250–75. Decided December 15, 1976]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; mutual mistake; reformation; liquidated damages v. penalty.**—Plaintiffs seek to recover earnest money paid to HUD as a deposit on a contract of sale for two parcels of land identified as Hampton Place I and II. The parcels were identified in the invitation to bid and at the top of the first page of the contract by project number; however, Schedule "A" of the contract described in detail Hampton Place II twice and omitted a description of Hampton Place I. After contract execution but before closing the sale, plaintiffs' counsel notified HUD of the description error, HUD prepared an accurate description to be attached to the documents at closing and extended the closing time, HUD granted a further extension of the closing in consideration of an additional earnest money deposit, plaintiffs refused to close within the appointed time, and HUD terminated the contract, retaining the earnest money deposits as liquidated damages as provided in the contract. Plaintiffs contend that since the contract was entered into under a mutual mistake of a material fact, no enforceable agreement came into existence, that the contract violates the District of Columbia Statute of Frauds

Syllabus

because of the misdescription, and that the liquidated damages clause constitutes an unenforceable penalty. It is *held* (1) that since plaintiffs affirmed correction of the agreement by requesting extensions of time for closing and never actually repudiated the contract until after it was terminated, reformation, rather than rescission, to correct the clerical misdescription is appropriate to reflect the true intent of the parties; (2) that the Statute of Frauds argument has been rendered moot by the reformation; and (3) that, in view of the various factors discussed, the liquidated damages provision was appropriate and is upheld. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Contracts; reformation; mutual mistake of fact.**

[1] This court has the power, where the written instrument fails to reflect the true intent of the parties through a mutual mistake of fact, to reform the contract to express the intention of the parties.

Courts ⟸ 448

**Contracts; rescission; mistake; generally.**

[2] Rescission of a contract because of mistake is appropriate only where the mistake affects the very essence of the agreement.

Contracts ⟸ 93(1)

**Contracts; damages; liquidated damages; interpretation of provision.**

[3] In order to determine whether a contract provides for liquidated damages as stated or whether it imposes a penalty for breach or default, the contract must be construed as a whole as of the date of its execution, taking into consideration (1) did the parties intend to provide for liquidated damages or a penalty, (2) does uncertainty in amount and difficulty in ascertainment of damages support the provision for liquidated damages, and (3) does the amount of damages bear a reasonable relationship to any actual damages that may be sustained as result of contract breach or default.

Damages ⟸ 76

**Pleading and practice; summary judgment; response to motion for summary judgment; general denial, effect of.**

[4] When a motion for summary judgment is made and supported as provided in Court of Claims Rule 101(f), an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in the rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, will be entered against him.

Courts ⟸ 470

*F. Robert Troll, Jr.*, attorney of record, for plaintiffs.

*Dorothy R. Burakreis*, with whom was *Assistant Attorney General Peter R. Taft*, for defendant. *Nicholas S. Nadzo*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and BENNETT, *Judge*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

Plaintiffs seek to recover $91,000 paid to the Department of Housing and Urban Development (HUD) in accordance with a contract by which plaintiffs intended to purchase, and HUD intended to sell, two parcels of realty located in Texas (designated Hampton Place I and II). In response to HUD's invitation to bid, plaintiffs submitted a sales contract prepared by HUD as the bid form. Both the invitation to bid and the top of the first page of the sales contract described or identified the project by number, and as Hampton Place I and II. It is undisputed that both parties at the time of execution believed the contract described Hampton Place I and II. However, Schedule "A" of the contract, designed to describe the realty in detail, through an error in draftsmanship, described Hampton Place II twice, and omitted any description of Hampton Place I.

Plaintiffs executed the agreement and made an earnest money deposit of $90,000 with HUD on May 14, 1974. The total contract price was to be $1,841,500. A provision in the contract (Paragraph 14) provided that this deposit be retained as liquidated damages in the event of breach by the purchaser. On August 1, 1974, HUD executed the contract in the District of Columbia. Closing was to be held no later than October 1, 1974.

On September 30, 1974, the then counsel for plaintiffs, Mr. Gilmore, notified HUD that he had discovered the error in the property description. HUD granted an extension of time for closing, the new date being October 11, 1974. On October 3, 1974, a HUD official informed plaintiffs that a complete and accurate property description had been prepared, and that this description would be attached to the appropriate documents at closing. In consideration for an additional $1,000 earnest money deposit, plaintiffs subsequently were granted a further extension date of November 1, 1974.

Plaintiffs refused to close within the appointed time. In a letter of November 22, 1974, HUD informed plaintiffs that the contract was terminated and the earnest money deposits would be retained as liquidated damages. HUD subsequently

sold the property in question on August 1, 1975 to a third party for a total sum of $1,853,000.

The contract was executed by the parties under a mutual mistake of fact as to the contract description of this property to be conveyed: the description of "Hampton Place II" twice, and the omission of any description of "Hampton Place I". At that time, both parties mistakenly believed that the contract described both Hampton Place I and Hampton Place II.

Plaintiffs urge that, since the contract of sale was entered into by the parties under a mutual mistake of a material fact, no enforceable agreement between the parties ever came into existence. This mistake in the property description neither induced plaintiffs to enter into an agreement they did not fully contemplate, nor did it lead them to rely upon the written contract to their detriment. In support of its cross-motion for summary judgment, defendant submitted affidavits by its counsel and officials that are not controverted by plaintiffs, and establish the following facts.

On September 30, 1974, counsel for plaintiffs, Mr. Gilmore, notified an attorney for HUD, Mr. Patton, of the error in the property description. Mr. Patton promptly informed Mr. Gilmore on or about October 3rd that HUD actually intended to sell both Hampton Place I and Hampton Place II, and that an accurate property description had been prepared which "would be substituted for the erroneous one in the documents which Mr. Gilmore would bring to the closing scheduled for October 11, 1974", according to the undisputed affidavit of Mr. Patton. This affidavit, along with the uncontroverted affidavits of Mr. Hilman and Mr. Divelbiss, also establishes that, through subsequent conversations with HUD officials, Mr. Gilmore requested a second extension of time for closing the sale due to "trouble with the trusts" or an internal problem among plaintiffs. At no time did plaintiffs' attorney indicate any intention to repudiate the contract of sale or demand a return of plaintiffs' earnest money deposits until after defendant notified plaintiffs that the contract of sale was terminated on November 22, 1974, for failure to close within the prescribed time. These relevant facts are established by affidavits of defendant's

officials or agents. They are not controverted by affidavits or specific facts by plaintiffs, and together with the other undisputed facts hereinafter set forth, are sufficient for entry of summary judgment for defendant.

This court has the power, where the written instrument fails to reflect the true intent of the parties through a mutual mistake of fact, to reform the contract to express the intention of the parties. *Sutcliffe Storage & Warehouse Co.* v. *United States*, 125 Ct. Cl. 297, 304, 112 F. Supp. 590, 593–94 (1953). Rescission, by contrast, is appropriate only where the mistake affects the very essence of the agreement.

> [A] mistake, in order to justify rescission, must relate to the intrinsic nature of the bargain; * * * a mistake in regard to a collateral matter or in regard to some matter which formed merely the inducement to a contract is said to be without effect. * * * [A] mistake vitally affecting a fact or facts on the basis of which the parties contracted renders their contract voidable by an injured party. 13 WILLISTON ON CONTRACTS, § 1544 (3d ed. 1970).

The key distinction to be made is whether the error in description affected the substance of the agreement, or whether it merely reflected an error in expression which was promptly recognized by both parties as not representing the intent of either. Plaintiffs affirmed correction of the agreement by requesting two extensions of time for closing the sale, and never actually repudiated the contract until February 3, 1975. This was four months after plaintiffs' counsel first notified HUD of the error in drafting the property description. Accordingly, the contract is reformed to encompass both parcels of real property, correctly described on page one of the Contract of Sale and Purchase as "Project: Hampton Place I and II; Project No.: 112–35089/141; City and State: DeSoto, Texas".

The argument of plaintiffs that the contract of sale and purchase violates the District of Columbia Statute of Frauds due to its incomplete and erroneous description of the property intended to be conveyed is now rendered moot by the reformation of the contract correcting this description to conform to the actual intent of both parties thereto.

Plaintiffs also argue that the liquidated damages clause in the contract constituted an unenforceable penalty. Paragraph 14 of the contract provides:

> Time is of the essence of this contract. The sale shall be closed within 60 days following the effective date of this contract at a place designated by the Seller, or at such other time as may be agreed to by the parties in writing. Should the Purchaser fail or refuse to perform his part of the contract promptly at the time or in the manner herein specified, *the earnest money deposited herewith shall, at the option of the Seller, be retained as liquidated damages.* [Emphasis added].

Both parties have cited *Davy* v. *Crawford*, 147 F. 2d 574, 575 (D.C. Cir. 1945) in support of their respective positions:

> This court has held that the parties to a contract may agree in advance to a sum certain which shall be forfeited as liquidated damages for breach of the contract without reference to the actual damages found at the time of the breach. But if such an agreement is for a penalty it is void. In order to determine whether or not the provision should be construed as a penalty the contract must be construed as a whole as of the date of its execution. If under the circumstances and expectations of the parties existing at the time of execution it appears that the provision is a reasonable protection against uncertain future litigation the provision will be enforced even though no actual damages were proved as of the date of the breach. If, on the other hand, it appears that the stipulation is designed to make the default of the party against whom it runs more profitable to the other party than performance would be, it will be void as a penalty. Thus, damages stipulated in advance should not be more than those which at the time of the execution of the contract can be reasonably expected from its future breach, and agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced.

We are required to make several inquires to determine whether this contract provides for liquidated damages as stated, or whether it imposes a penalty. First, did the parties intend to provide for liquidated damages or a penalty? *Wise* v. *United States*, 249 U.S. 361, 365 (1919). Second, does uncertainty in the amount and difficulty in ascertainment of

damages support the provision for liquidated damages in this contract? *Barnette* v. *Sayers*, 289 F. 567, 570 (D.C. Cir. 1923). Third, does the amount of damages bear a reasonable relationship to any actual damages that may be sustained as a result of default? *Davy* v. *Crawford*, 147 F. 2d at 575.

The parties expressly provided for liquidated damages in Paragraph 14 of the contract. Elements of damages that were not uncertain, and could have been determined at the time of execution of the contract, include future real estate taxes, carrying charges, loss of interest charges, costs of readvertising the sale, and continuing maintenance costs. However, there are other areas in which HUD could have sustained future substantial losses which were not definitely ascertainable when the contract was executed. For example, the litigation against which the liquidated damages of $90,000 were designed to protect is still ongoing; these costs remain to be calculated. When defendant did attempt to sell after plaintiffs' breach of the contract, a minimum bid of $1,728,000 was sought, which could have resulted in a loss to defendant of the $113,500 difference between the minimum bid price and plaintiffs' contract price of $1,841,500. The resale to a third party took place nine months after plaintiffs' contract was to have been closed, and was for $1,853,000, or a gain to defendant of $11,500 over plaintiffs' original sale price. This fluctuation in sales prices demonstrates that there was considerable uncertainty in sales prices within a one-year period from the execution of the contract.

The affidavit of Mr. Cameron, who supervised the management and sale of all HUD-owned property, establishes that the estimated amount of liquidated damages in this case was well within the range of similar estimates established by HUD's past experience and practice. An earnest money deposit must be submitted on each bid to insure that only serious bids are received. The provision for liquidated damages was a standard provision, and represents a rough estimate of the actual future damages that HUD might sustain in case of default by a purchaser. The amount of required earnest money is based on a percentage of the minimum bid price or of the estimated value of the property. The great majority of HUD sales are for properties valued from

about $100,000 to $2,000,000 and, within this range, HUD's general rule is to request an earnest money deposit of roughly five percent of the estimated value of the property, which is approximately the amount of the earnest money paid by plaintiffs in this case. In the case of default by a purchaser, HUD's practice is to retain the earnest money deposited by the purchaser as liquidated damages, and not to seek additional compensation through litigation. These relevant facts, established by the Cameron affidavit for defendant, are not controverted by affidavit or specific facts by plaintiffs. All of these factors, taken together, support the conclusion that the liquidated damages provision in the contract was "a reasonable protection against uncertain future litigation * * * even though no actual damages were proved as of the date of the breach." *Davy* v. *Crawford*, 147 F. 2d at 575.

According to the affidavit of Mr. Hilman, an official of HUD, the attorney for plaintiffs stated on October 14, 1974, that plaintiffs "would submit $1,000 in exchange for a two-week extension of time for closing the sale", and the second extension of time was granted upon receipt of this amount. As in the case of the $90,000 earnest money deposit, plaintiffs cannot prevail on their claim that this $1,000 payment should constitute an unlawful penalty. This second extension of time, for which plaintiffs paid $1,000, is totally inconsistent with their attempt to disaffirm the contract several months later.

All of the facts established by the aforesaid affidavits for defendant are uncontroverted by plaintiffs and, together with the other undisputed facts, are sufficient for summary judgment under our Rule 101(f).[1] Accordingly, we conclude that the contract is reformed to correct the clerical misdescriptions of the property in the contract; plaintiffs' Statute of Frauds

[1] Rule 101(f) of this court provides:

"Form of Affidavits; Further Testimony: Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions or by further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, will be entered against him."

argument is rejected; and the liquidated damages provision is upheld.

Plaintiffs' motion for summary judgment is denied, and defendant's cross-motion for summary judgment is granted. Plaintiffs' petition is dismissed.

---

546 F. 2d 378

## ALFRED AND ESTELLE MINOT AND HERBERT AND EMILY JOHNSTON v. THE UNITED STATES AND GUAM POWER AUTHORITY

[No. 358–75. Decided December 15, 1976]

ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

**Eminent domain; taking; actions by local government instrumentalities.**—In 1950 the United States acquired by condemnation and paid for a perpetual easement over plaintiffs' properties for power transmission lines, and pursuant thereto 40-foot wooden poles were erected supporting a 34-KV line. In 1972 the United States and the Guam Power Authority (GPA) entered into a power pooling agreement whereby GPA could use the said easement. In 1973 the agreement was amended granting GPA permission to enter the easement lands for any proper purpose under the agreement, including use of the site for installation, etc. of power transmission facilities. Thereafter GPA erected a 75-foot tower supporting a 115-KV line on the easement and straddling the property line between plaintiffs' residential properties. Plaintiffs seek compensation for an alleged taking by the United States of their property. Defendant contends that if a taking occurred it was not done by the United States but by GPA. It is *held* that when defendant granted GPA permission to enter its easement it did not take by inverse condemnation a further compensable interest in plaintiffs' properties, nor is defendant liable for a taking because of GPA's actions in erecting the tower for the 115-KV transmission line. Defendant's motion for summary judgment is granted, and the petition is dismissed without prejudice to the right of plaintiffs to bring suit against GPA in a court of competent jurisdiction.

**Court of Claims jurisdiction; parties; third party, interpleading of.**
[1] This court lacks jurisdiction to adjudicate suits between third parties.

Courts ⇐ 448

**Eminent domain; taking; what constitutes.**
[2] Where the United States in allowing a third party to enter upon its permanent easement on plaintiffs' properties for installation of powerline facilities granted no more of a property interest

in the easement than it had a common law right to do, without the exercise of sovereign power, such action does not constitute a Government taking by inverse condemnation of a further compensable interest in plaintiffs' properties.

Eminent Domain ⟸ 2(1)

**Eminent domain; taking; actions by local government instrumentalities.**

[3] To the extent that the third-party, a local government instrumentality, in making use of the 34–KV United States' permanent easement over plaintiffs' lands and erecting a 115–KV tower and line thereon, acted inconsistently with plaintiffs' property rights, said third party may be held to account in a forum other than the Court of Claims for an inverse condemnation. The United States bears no liability under the Fifth Amendment for such independent local action.

Eminent Domain ⟸ 285

*Thomas J. Perham*, attorney of record, for plaintiffs. *Barrett, Ferenz, Bramhall & Williams*, of counsel.

*Anthony S. Borwick*, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

*Fred E. Bordallo*, attorney of record, for Guam Power Authority.

---

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This is a taking claim brought against the United States, defendant, and the Guam Power Authority (GPA), co-defendant, by plaintiffs Minot and Johnston, who seek $400,000 as just compensation. Plaintiffs are owners of real estate in the Territory of Guam. The United States took and paid for a perpetual easement through their properties in 1950, as clarified by an amended declaration of taking in 1955, "for the use of the United States * * * for the construction, maintenance, operation, repair and patrol of a 34–KV [electrical] Line and a Petroleum, Oil and Lubrication Line." Pursuant to this easement, a 34–KV line was built and operated over plaintiffs' property, supported by wooden poles 12 inches in diameter and 40 feet high.

The GPA is a public corporation of the Territorial Government of Guam, with the power of eminent domain and

the power to sue and be sued in its own name. On October 5, 1972, GPA entered into a power pooling agreement with the United States, whereby GPA could use Government-owned property. The purpose of this agreement was to enable GPA to take over the island's power system from the Department of the Navy, so that, thereafter, Department of Defense installations would become customers of GPA. The agreement was amended on September 27, 1973, to include a provision by which the Government "grant[ed] to the [GPA] * * * a revocable permit to enter the lands of the Navy for any proper purpose under this Agreement, including use of a site or sites, right-of-way or rights-of-way, * * * for the installation, operation, and maintenance of the facilities of the Authority required to be located thereon." In consideration for the grant of this permit or license, GPA paid the United States $99,400. During negotiations for the permit, the Government learned that GPA was contemplating the erection of a 115–KV line in place of the 34–KV line existing on the easement over plaintiffs' properties.

Sometime after the power pooling agreement was amended as above, GPA went forward with its plans and constructed the 115–KV line supported on steel towers 75 feet high and 30 feet square at the base. The tower complained of here was erected on the easement and straddled the property line between plaintiffs' residential properties. It is quite near their houses. Plaintiffs brought suit against both the United States and GPA in the United States district court in Guam, alleging that the United States had no right to "license" GPA to use its easement over plaintiffs' lands, and that the resulting development intolerably burdened and depreciated their properties, amounting to a taking. The district court dismissed the action against GPA for lack of jurisdiction, and transferred the claim against the Government to this court pursuant to 28 U.S.C. § 1406(c) (1970). In this court, the United States answered that if there had been a taking, it was by the action of GPA alone. GPA was therefore ordered by the court to appear and defend pursuant to Rule 41(a)(1). GPA then answered, denying liability and cross-petitioning against the United States on the theory that if we should find plaintiffs entitled to recover from GPA, the

Government should indemnify GPA. By order on September 10, 1976 [unreported], we dismissed the cross-petition, since this court has no jurisdiction to adjudicate suits between third parties. *Rolls-Royce Ltd.* v. *United States*, 176 Ct. Cl. 694, 364 F. 2d 415 (1966).

This case is presently before the court on the Government's motion for summary judgment, to which plaintiffs have responded but GPA has not. The issues to be decided now are whether, when defendant granted GPA permission to enter defendant's easement for the installation of powerline facilities, it thereby took by inverse condemnation a further compensable interest in plaintiffs' properties, and whether the United States is liable for a taking by virtue of GPA's actions in erecting the tower for the 115–KV transmission line on plaintiffs' lands. On these issues we hold for the United States.

Plaintiffs first argue that the Government could not, short of taking another easement over their lands and paying for it, create a right in a third party to make use of the Government's existing easement. Plaintiffs note that the 1955 declaration of taking of the easement specified that the taking was "for the use of the United States," and submit that use of that easement by GPA (even if partly for the benefit of Government installations) is not use for the United States. They conclude that the Government's attempt by permit to multiply the number of users of the exising easement burdens the easement beyond the scope of the original taking, and thus amounts to an additional exercise of eminent domain entitling plaintiffs to compensation. We need not decide whether the United States was within its rights under the original easement in licensing GPA, or whether the issuance of a license or permit to a third party constitutes a taking, for we think that the Government granted by its permit to GPA no more of a property interest in its lands than it had a right to do as a private individual, without the exercise of sovereign power.

Certain papers attached as exhibits to defendant's motion show that the permit "to enter the lands of the Navy" was little more than an agreement by defendant United States

not to consider GPA's use of Government property a disturbance or obstruction to the Government. The Navy officers who negotiated and approved the permit decidedly did not convey any property interest that the United States had no common law right to pass to another, but merely attempted to allow GPA to use Government interests in property to the extent they had the right to allow it, without setting out in detail what the extent of that right was. The permit spoke in broad, general terms of the "lands of the Navy," yet a letter from the Navy's officer in charge of construction in the Mariana Islands to the Pacific Division commander of the Naval Facilities Engineering Command, dated April 3, 1973, recognized that the Government's interests in different parcels of realty varied, and that the permit to GPA might well carry with it different rights with respect to an easement taken "for the use of the United States" than with respect to an easement taken for the Government's "use and benefit." This theme was echoed in the Pacific Division commander's letter of June 13, 1973, to the commander of the Naval Facilities Engineering Command, suggesting that there might be a problem regarding the extent of the rights passed to GPA under the permit, but declining to resolve the issue except to say that the final responsibility for the acquisition of property rights was left with GPA, which knew that the permit would not always be adequate. The June 13 communication read in part:

> 4. Conveyance of easements to GPA presupposes that the Government's estate is legally sufficient to permit such conveyance. There will be occasions when GPA may wish to use existing Navy utility easements and it will be found that the easement estate is not sufficient to permit such use. In these situations, it will be necessary for GPA to obtain its easement estate from the owners of the underlying fee by direct negotiation. The Navy would, of course, have no objection to these secondary easements.

The letter went on to note, by way of example of the preceding point, that while GPA had requested the Navy's permission in February of 1973 to use the Government's 34–KV line easement from Piti Power Plant to the Agana Diesel Plant, "GPA is now [June 1973] aware of the necessity for

it to obtain its desired easement right from the owner of the underlying fee and is proceeding to do this." Thus, the Navy officers recognized the limited scope of the permit they issued to GPA well before they gave final approval to the amendment implementing it. To the extent that GPA, in making use of the 34–KV easement over plaintiffs' lands and erecting a 115–KV tower and line thereon, acted inconsistently with plaintiffs' property rights, it may be held to account for an inverse condemnation in the Superior Court of Guam. There is no contention that GPA acted as the agent of the United States when it constructed the tower.

Plaintiffs also claim that the United States is liable for the damages they suffered when GPA built its 75-foot high-voltage transmission line tower on their lands. They aver that the Navy knew about GPA's plans for the 115–KV line when it issued the permit, which was in fact the case, and that the permit was thereafter approved, leading to the conclusion that the United States authorized construction of the high-voltage line and must now pay for it. The foregoing discussion provides the answer to this claim for the most part. The permit issued by the United States did not authorize GPA to do anything that the Government had not the common law right to allow it to do. A Navy letter dated January 31, 1974, did forward to the Public Works Center on Guam a certificate of acceptability for GPA's "use of Navy lands and land interests for the 115–KV power transmission line" which crossed plaintiffs' properties, but this amounted to no more than the Navy's further assent to GPA's disturbance of its easement. Importantly, we think, it was GPA, on its own initiative and at its own expense, that decided and proceeded to build the 115–KV line and the supporting tower. GPA was an independent entity, one that could decide to build or not to build the new line and tower, one that was not instructed by the Government to build them or not to build them. If GPA, as a local government instrumentality, condemned an interest in plaintiffs' lands when it erected the line and tower, it did so on its own account and without relation to anything that the Navy did. The United States bears no liability under the Fifth Amendment for such independent local action. *Garden Constr. Co.* v. *United*

*States*, 191 Ct. Cl. 372, 423 F. 2d 273 (1970). We have carefully examined all of the authorities relied upon by the parties but find it unnecessary to discuss them in view of our disposition of this case upon its facts as discussed above.

Upon consideration of defendant's motion for summary judgment, plaintiffs' response in opposition thereto, and defendant's reply, without oral argument, it is concluded that defendant's motion for summary judgment should be and it is granted, and the petition is dismissed, without any prejudice, however, to the right of plaintiffs to bring suit against the Guam Power Authority in a court of competent jurisdiction.

---

546 F. 2d 381

## KABUA KABUA, ET AL. v. THE UNITED STATES

[No. 119–75. Decided December 15, 1976. Plaintiffs' motion for rehearing *en banc* requesting reconsideration denied February 4, 1977]*

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Eminent domain; taking; limitation of actions; Trust Territory property.**—Plaintiffs claim they are the indigenous landowners of Roi-Namur, an island component of the Trust Territories administered by the United States. Since 1960 the United States has been exclusively using and occupying the island as a missile range with the permission of the Trust Territory government in consideration of payment of $80,000. The land is to be returned to the Trust Territory government when it is no longer needed by the United States pursuant to the Use and Occupancy Agreement. In June 1953 the High Commissioner approved a regulation announcing procedures for adjudicating claims of land ownership, including release of any land no longer needed by the United States. In November 1962 and March 1964 the Trust Territory government published notices that Roi-Namur was considered public land owned by the government, but invited submission of private claims. Plaintiffs filed claims in 1963 and 1964 contending that the land granted to the United States was private property and not subject to disposition by the Trust Territory government. The Land Management Administrator determined that the head chiefs' rights in the land were in plaintiffs. In 1965 plaintiffs agreed to allow the United States to retain undis-

---

*On May 5, 1977 plaintiffs filed a petition for a writ of certiorari.

Syllabus

turbed possession of the land pending negotiations toward compensation, and since then plaintiffs have dealt with and managed their unresolved claims solely as a money claim. The parties seem to agree that the United States will pay something, but the amount is not settled. Plaintiffs filed suit here on April 15, 1975 for an uncompensated taking of their lands. It is held (1) that the suit is barred by the court's 6-year statute of limitations, 28 U.S.C. § 2501. The United States since 1960 has been in open and notorious possession under claim of right, has made large improvements, and the use has never varied; (2) that the mere possibility of a reverter after use as a missile range ceases does not serve to toll the statute; (3) that neither the land title proceedings before the Land Management Administrator nor the unsuccessful settlement negotiations tolled the statute; (4) that if the letter of December 1, 1965 constituted an implied-in-fact contract, any possible claim founded thereon accrued more than 6 years before suit was brought; (5) that the ouster of the Trust Territory government and the Department of the Interior from conduct of the settlement negotiations and substitution of the Department of Defense do not toll the statute or accrue a new claim; and (6) that an obligation based on the United Nations Trusteeship Agreement does not add to this court's jurisdiction. Plaintiffs' motion for summary judgment is denied, defendant's cross-motion is allowed, and the petition is dismissed.

**Limitation of actions; accrual of cause of action; eminent domain claims.**

[1] To avoid the bar of 28 U.S.C. § 2501, the claimant must bring his suit in the Court of Claims within 6 years of the taking date.

Courts ⇐ 461(2)

**Court of Claims jurisdiction; eminent domain; taking; quiet title issue present.**

[2] A suit to try title is cognizable in this court on a taking theory.

Courts ⇐ 448

**Limitation of actions; accrual of cause of action; continuing claim; eminent domain claim.**

[3] A continuing claim tolling the running of the statute of limitations is based on the theory that when a taking occurs over a period of time, the property owner is entitled to wait until the full extent or duration of the uncompensated taking becomes clear before filing suit therefor. Where the subject land has been used and occupied by the United States since 1960 under permission of the Trust Territory government and the use has never varied with long retention obviously visualized in view of the construction of facilities as part of the Kwajalein Missile Range, the mere possibility of a reverter after missile range use might be unilaterally declared to be at an end cannot serve to toll the statute.

Courts ⇐ 461(3)

**Contracts; limitation of actions; accrual of cause of action; breach of contract claim.**

[4] A claim on an implied contract with the United States accrues when it can be definitely ascertained and set up, when the one who is bringing suit has done all that is required of him by the terms of the contract.

Courts ⇐ 461(4)

**Court of Claims jurisdiction; treaty claims.**

[5] The Court of Claims does not have jurisdiction of claims founded on treaties.

Courts ⇐ 448

**Court of Claims jurisdiction; generally.**

[6] The jurisdiction of the Court of Claims is always strictly construed because it depends on the consent of the sovereign to be sued, and is not to be extended by implication. A claim based on moral grounds does not weigh in this court, unless it is made a legal ground by statute.

Courts ⇐ 448

*Stephen N. Shulman*, attorney of record for plaintiff. *Joseph A. Artabane*, and *Cadwalader, Wickersham & Taft*, of counsel.

*Herbert Pittle*, with whom was Assistant Attorney General *Peter R. Taft*, for defendant.

---

Before SKELTON, NICHOLS and KASHIWA, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

The plaintiffs have brought this action to recover for an alleged uncompensated taking of Roi-Namur Island. The parties have filed voluminously documented cross motions for summary judgment. Among other defenses, defendant sets up the jurisdictional bar of our six-year statute of limitations, 28 U.S.C. § 2501, which applies to all claims in this court. Since we determine that the suit is barred for that reason, we need not consider the other matters the parties have briefed and argued, and we do not do so.

Plaintiffs say they are the indigenous landowners of Roi-Namur, which is a Micronesian island, part of the Marshalls, a component of the Trust Territories of the Pacific islands, which the United States administers under its Trusteeship Agreement with the United Nations, 61 Stat. 3301. Thus, the chief executive of the government of the Trust Territory, a

High Commissioner, is appointed by the President of the United States with the advice and consent of the Senate. Since 1960, the United States has been using Roi-Namur with the permission of the Trust Territory government, which consented to United States occupancy in consideration of payment of $80,000. Under this Use and Occupancy Agreement, the United States' needs for the lands are to be reviewed by it each five years, and the land is to be returned to the Trust Territory when no longer needed.

The groups of plaintiffs, comprised of head chiefs (Iroij), lesser chiefs (alabs), and tenants (dri jerbal), or their ancestors, had inhabited Roi-Namur when Japan assumed control over the territory under a League of Nations mandate. The Japanese government at some time before 1944 built an airbase there, filling in a lagoon and joining Roi and Namur, which had hitherto been two separate islands. They expelled the natives, and the plaintiffs resided elsewhere until after World War II. There is evidence that the Japanese purported to pay compensation, but whether to the right persons and in adequate amounts, we need not determine. In February 1944, United States forces overwhelmed the Japanese garrison in a bloody battle, and thereafter used Roi-Namur as a base until hostilities ended.

In 1949 the Navy suffered a few Marshallese to return to Roi-Namur. That they were the plaintiffs or any of them is not asserted. In 1960 they were removed, leaving behind eight dwellings, a church, and some thirty other structures. Since 1960 no Marshallese person has been allowed to reside upon or use Roi-Namur. The island then became and now is part of the Kwajalein Missile Range. There are structures and improvements, of value approximately $100,000,000, added to the realty in furtherance of this use, since 1960. The Use and Occupancy Agreement does not refer to or recognize any native claims, but rather seems to visualize that on the termination of the present use, the island will revert to the Trust Territory government as part of its public domain.

On June 29, 1953, the High Commissioner had approved Office of Land Management Regulation No. 1, which announced the procedures before the Land Management Administrator for the adjudication of claims of land ownership throughout the Trust Territory. Section 3 of the Regulation

further authorized an appropriate official to release to the owner any tract of private land that was no longer needed by the United States. In November 1962, and again in March 1964, the Trust Territory government published notice that Roi-Namur was considered public land owned by the government, but invited the submission of any private claims. The plaintiffs in this action filed claims under the Regulation in regard to the land on Roi-Namur in 1963 and 1964, objecting that the land granted to the United States was private property and not in the public domain subject to the disposition of the Trust Territory government. The Land Management Administrator determined that the "Iroij" rights in the land were in the plaintiffs. There has been no formal appeal of this determination, but the defendant does not agree with it.

Although their title to the lands occupied by the United States under the Use and Occupancy Agreement had been recognized to that extent, plaintiffs did not seek to eject the United States, but only to obtain the compensation ostensibly due them. Accordingly, by their letter to the High Commissioner dated December 1, 1965, plaintiffs said they agreed to allow the United States to retain undisturbed possession of the land, pending negotiations toward compensation. Since then they have dealt with and managed their claim as a money claim entirely. Negotiations toward plaintiffs' conveying to the United States a long term lease for a consideration did commence, but continued without success through 1974. When plaintiffs were convinced that continuing with negotiations would be unavailing they filed suit here, April 15, 1975. The parties seem to agree that the United States will pay something, but are wide apart as to what payment would be fair and just. An appraisal was made in 1970 proposing a rental value of Roi-Namur at $7,666.67 per acre as a lump sum for a 50 year period to end February 6, 1994. The Navy has rejected it.

The law is clear that to avoid the bar of § 2501, *supra*, the claimant must bring his suit within six years of the taking date. *Hilkovsky* v. *United States*, 205 Ct. Cl. 460, 504 F. 2d 1112 (1974); *Camacho* v. *United States*, 204 Ct. Cl. 248, 494 F. 2d 1363 (1974). We pass over any happening before 1960, but since that date the United States has been in open and

notorious possession under claim of right, and has made large improvements, under an agreement with the Trust Territory which purported to act as the owner. The Navy's possession is indeterminate in duration, subject only to a return of the island to the Trust Territory at some time when, by the Navy's own unilateral determination, its use is at an end. If the suit is one to try title, as plaintiffs seem to express it at times, it is cognizable in this court on a taking theory. *Bourgeois* v. *United States*, *ante* at 32, 545 F. 2d 727 (1976). The facts are consistent with no other view than that whatever ownership the plaintiffs have was taken long since.

The plaintiffs seek to avoid the bar by saying they were entitled to wait until the duration of the taking was announced, since it was avowedly temporary. They cite *United States* v. *Dickinson*, 331 U.S. 745, 749 (1947); and *Castro* v. *United States*, 205 Ct. Cl. 534, 500 F. 2d 436 (1974).

The former case is by *United States* v. *Dow*, 357 U.S. 17 (1958), more or less limited to the class of flooding cases to which it belonged, when the landowner must wait in asserting his claim, until he knows whether the subjection to flooding is so substantial and frequent as to constitute a taking. *Dow* holds the usual rule to be that the taking occurs when the United States first enters into possession, and not when it acquires title. P. 22. In *Castro*, the opinion outlines a temporary taking for varying and different temporary reasons, the first, the presence of an ammunition dump in the area, next the stationing of the NTTU, and finally because of the hazards of live explosives buried in the soil. But the land was never included in the military's list of lands designated for military retention areas. It is easy to see superficial similarities since the *Castro* lands were on Saipan, in the Pacific war zone and the subsequent Trust Territory. But here we have a use commenced in 1960 and never subsequently varied, with long retention obviously visualized in view of the large construction of facilities. The mere possibility of a reverter after the missile range use might be unilaterally declared to be at an end, can in no way serve to toll the statute in the same manner as the varied and multiple uncertainties as to the taker's intentions, spelled out in the *Castro* decision.

Here, in a timely suit, plaintiffs could have successfully urged that as of a 1960 taking date, the possibility of a reverter was too remote and uncertain to impede the prompt ascertainment of an award, which necessarily would, with respect to *quantum*, have been not materially less than the entire value of the land taken as a fee simple.

As held in *Camacho*, the land title proceedings before the Land Management Administration did not toll the statute. Nor can mere settlement negotiations, as conducted subsequently, ever do so. The United States was not a party before the Land Management Commissioner, and his determination for plaintiffs could not and cannot be taken as determining that the United States was not in possession as a taker at the time. At most it qualifies them as claimants, or purports to do so. Accordingly, we think the statute of limitations had run on the taking claim before the petition was filed herein.

Plaintiffs also rely on what they call an implied-in-fact contract. They interpret their letter of December 1, 1965, as permitting the continued occupancy by the United States, conditioned on payment of compensation. Though addressed to the Trust Territory Commissioner, somehow it embodied a contract with the United States. Presumably it was in their view an offer, accepted by continued occupancy and by conduct of negotiations to determine the quantum of compensation. Whether inadvertently or not, defendant lent some support to this view by admitting in its answer a petition allegation that it held possession "under the terms of the December 1, 1965, Iroij letter." It seems clear from all the facts submitted on the cross motions that defendant is holding under its 1960 Use and Occupancy Agreement with the Government of the Trust Territory. If, however, plaintiffs conveyed any interest in 1965, this was still over nine years before suit was brought and the negotiations for the pecuniary *quid pro quo* have or should have gone on almost as long. By the 1965 letter, they were to commence "at an early date." A claim on an implied contract with the United States is held to accrue "when it can be definitely ascertained and set up, when all that is required of him by the terms of the contract has been fulfilled by the contractor." *Steel Improvement Co. v. United States*, 174 Ct. Cl. 24, 28, 355 F. 2d 627, 630 (1966).

We hold, therefore, that any possible claim founded on an implied-in-fact contract accrued more than six years before suit was brought.

The plaintiffs say that on February 14, 1974, the United States Office of Management and Budget ousted the Trust Territory Government and its "overseer," the Department of the Interior, from conduct of the settlement negotiations, and substituted the Department of Defense. We see no way by which this act could be held to toll the statute or accrue a new claim. Of course any suit whenever brought would all along have had to be predicated on the proposition that the United States, not the Trust Territory Government, was the taker in possession or the party who made the contract implied-in-fact. If the obligation to be enforced was that of the latter, the Trust Territory, jurisdiction here would be lacking on another ground. *Porter* v. *United States*, 204 Ct. Cl. 355, 496 F. 2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975).

Plaintiffs also assert support of their claim by the United Nations Trusteeship Agreement; however, the general obligation thereby created, to protect the natives against the loss of their land and resources, does not add anything to our jurisdiction as Congress has spelled it out. This does not include claims founded on treaties, 28 U.S.C. § 1502, but if it did, the six year period of limitations would apply still, and bar the claim.

Our inability to resolve the long impasse on quantum is no doubt regrettable, since it is doubtful whether plaintiffs can recover anywhere else against the taker in possession. However, our jurisdiction is always strictly construed because it depends on the consent of the sovereign to be sued, and is not to be extended by implication. *United States* v. *King*, 395 U.S. 1 (1969); *United States* v. *Testan*, 424 U.S. 392 (1976). Here, as in the cases cited, our desire to be of service is countervailed by the limitations on our jurisdiction. It would appear, however, that the willingness of defendant to pay something here is possibly based as much on moral as on legal grounds. The former category does not weigh in this court, unless it is made a legal ground by statute. Defendant's able counsel must resist every claim with every available defense, that private

counsel might properly use to defend a private client. Therefore, plaintiffs are often astounded to encounter objections to the very existence of their claims, that were not heard of or not urged in the prior negotiations. Our recognition that the Statute of Limitations defense is valid enables us to ignore others that could well be equally decisive here. The reader must not suppose that defendant has allowed them to appear waived or neglected. In general, we think a tribunal like this is not likely to be able to come up with a morally satisfactory resolution of a native or tribal claim, unless it has the support of special jurisdictional legislation comparable in its thrust to the Indian Claims Commission Act of 1946, 25 U.S.C. § 70 and ff., which allows enforcement of specified kinds of moral claims, not that we urge it as a model to follow in all details. Better yet perhaps it may be to relieve poverty where it is found, without going through elaborate and costly ritual designed to show that compensation is being assessed for an ancient wrong. Plaintiffs' able counsel has done as much as anyone could for his clients, but the Tucker Act, 28 U.S.C. § 1491, just simply is not an implement suited to his need.

Accordingly, upon review of the motions and supporting documents, and upon briefing and oral argument, it is ordered that plaintiffs' motion for summary judgment is denied, defendant's motion for summary judgment is allowed, and the petition is dismissed.

---

547 F. 2d 1106

## STEPHEN PITCAIRN, AGENT (SUBSTITUTED FOR AUTOGIRO COMPANY OF AMERICA) v. THE UNITED STATES

[No. 50328. Decided December 15, 1976]*

ON THE PROOFS

**Patents; infringement; accounting; reasonable and entire compensation; similarity proofs; royalty rate; delay compensation; experimental use.**—In *Autogiro Co. of America* v. *United States*, 181 Ct. Cl. 55, 384 F. 2d 391 (1967), the court held that certain claims of 11 patents owned by plaintiff were valid and that specific claims were

*See order of March 4, 1977, *post* at 224. The opinion of December 15, 1976 has been amended to reflect the changes set forth in the said order.

Syllabus

infringed by seven different models of helicopters manufactured for defendant under contract with named companies. Thereafter, the case was returned to the trial division for taking of evidence respecting the amount of recovery to which plaintiff is entitled, a recommended opinion, findings of fact and conclusion of law were filed, and the case is now before the court on the parties' exceptions thereto. The issues before the court are: the similarity or non-similarity of some 39 models of rotary-wing aircraft to any of the representative models which the court has held to be infringing, and computation of the reasonable and entire compensation to which plaintiff is entitled. The court has adopted, modified and deleted certain portions of the recommended decision. It is *held* (1) that in view of plaintiff's unchallenged and uncontradicted evidence establishing similarity, and in most instances the identity as to the assertedly similar structures, and in view of the paucity of any credible evidence from defendant of non-similarity, plaintiff's assertions on similarity are found to be fully supported by the record; (2) that, for the reasons given, royalty compensation at a rate of 2% should be accepted for all infringements (except for the first year and one-half); (3) that defendant's contention that royalty compensation should be computed at rates of less than 1%, based on its contention that plaintiff's contribution to the industry was minimal, is without merit; (4) that defendant's contention that plaintiff is not entitled to royalties for spare-part hub assemblies and rotor blades is without substance; (5) that in view of the evidence relating to the trends indicated by Moody's Composite Index of Yields on Long Term Corporate Bonds and the circumstances involved in this prolonged litigation, it is reasonable to divide the delay period of 1947–1975 into several periods and to utilize rates varying between 4% and 7½%, with the delay compensation to be computed on a calendar year basis with interest starting on January 1 of each year on the royalties accrued during the preceding calendar year; (6) that since plaintiff did not include attorneys' fees in the requested reasonable and entire compensation before the trial judge, no determination with respect to attorneys' fees, witness fees and expenses is made; (7) that rather than calculate delay damages based on the average annual yields of a series of hypothetical long-term Government bonds as urged by defendant, the court has concluded for the reasons given that the appropriate calculation should be based on long-term corporate bond yields; and (8) that experimental use is not a defense in the present litigation. Plaintiff is entitled to recover from the United States in accordance with the opinion, and judgment is entered for plaintiff to that effect with the amount of recovery including both the basic amount of compensation and delay compensation, to be determined pursuant to Rule 131(c).

**Patents; infringement; accounting; evidence; similarity proofs.**

[1] Evidence relating to similarity or identity between adjudicated infringing models and additional assertedly similar models consist-

ing of comparison of pertinent structures and operation of adjudicated infringing devices with corresponding structures and operation of assertedly similar models is procedure which is in accord with principles enunciated in *Marconi Wireless Tel. Co.* v. *United States*, 99 Ct. Cl. 1 (1942), *mod.* 320 U.S. 1 (1943).

Patents ⟸ 312(2)

**Patents; infringement; accounting; evidence; similarity proofs.**

[2] Proof of similarity may be limited to the subject matter of but a single claim of each patent found valid and infringed by the adjudicated models, thereby establishing the required proof of similarity in reference to the subject matter. It is not required that "similarity" be established as to a given structure in respect to *all* claims of varying scope found to be infringed. By the same token, the scope of the royalty base for the various patent claims in suit varies in accordance with the scope of the claimed subject matter.

Patents ⟸ 312(6)

**Patents; license; use by Government; eminent domain taking.**

[3] Use or manufacture by or for the Government of a device or machine embodying any invention protected by a United States patent, is a taking of property by the Government under its power of eminent domain. The nature of the property taken is a license in the patent, the claimed invention of which is used or manufactured by or for the Government, and such license continues throughout the life of the patent, or the period of infringing procurement, whichever is shorter.

Eminent Domain ⟸ 2(1)

**Patents; limitation of actions; accrual of cause of action; infringement claim.**

[4] At least where the scope and duration of the interest taken by the Government at the time of the first unauthorized use of the patented device cannot be ascertained, the cause of action does not accrue at the first taking for all future Government acquisition; takings occur within the purview of 28 U.S.C. § 1498 whenever the Government procures or uses a device covered by the infringed patent without a license.

Courts ⟸ 461(4)
Eminent Domain ⟸ 63

**Patents; infringement; accounting; compensation; royalty rate.**

[5] Where the recovery period for patent infringement of the aircraft in issue extends from November 1946 to May 1964, the court is justified in disregarding the wartime rate as a proper guideline for said period not only because it preceded the recovery period but because the particular circumstances of wartime procurement of patent licenses make it difficult to equate the very low-level wartime rate with fair market value for the post-war period or with an estab-

Syllabus

lished post-war license policy. Likewise, pre-war royalty rates are not suitable guidelines where plaintiff offered throughout the industry roughly contemporaneously with the beginning of said period a new rate of 2% which it deemed satisfactory. The mere surmise that a bargained license may possibly include some discount for litigation-avoidance does not *per se* preclude use of an accepted commercial rate as establishing reasonable and entire compensation.

Patents ⟸ 319(1)

**Eminent domain; taking; just compensation; valuation evidence.**

[6] Statements made in the process of making an offer concerning facts in the controversy which are not mere concessions made for the purpose of such offer are admissible against the party making them.

Patents ⟸ 319(1)

**Patents; infringement; accounting; compensation; royalty rate; Royalty Adjustment Act of 1942.**

[7] Since the standard of the Royalty Adjustment Act of 1942 in fixing wartime royalties was fair and just compensation, it cannot be assumed without proof that the mere naked existence of the statute had a depressing effect on the royalty rate used by plaintiff in commercial licensing.

United States ⟸ 69(5)

**Patents; infringement; generally.**

[8] A patentee cannot obtain an injunction against a government-supplier or government-contractor and is confined, for his exclusive remedy, to a suit for "reasonable and entire compensation," i.e. monetary compensation, against the United States under 28 U.S.C. § 1498.

Patents ⟸ 17

**Patents; infringement; accounting; compensation; royalty rate; spare parts.**

[9] Having determined that a 2% royalty rate for the Government's use of the infringing devices is appropriate, the total royalty for spare parts and assemblies embodying, manufactured or operating according to the patented inventions for use in the devices may not exceed 2% of their total sale value.

United States ⟸ 69(5)

**Patents; infringement; accounting; compensation; delay compensation.**

[10] The "reasonable and entire compensation" due a patent owner under 28 U.S.C. § 1498 includes not only reasonable royalties but also an appropriate amount which compensates the owner for the Government's delay in payment of royalties. The "reasonable and entire compensation" was intended to accomplish complete justice as between the patent owner and the United States. The amount due as

delay compensation is determined by multiplying the annually accrued royalties by an appropriate annual percentage rate, the periods of time covered by the computation of the additional amount extending from the dates of the Government procurement until the date of payment of the court's judgment. The rate to be used to calculate delay compensation from 1946 to payment of judgment should follow the changes in yield rates, which may be determined by refernce to an established, well recognized, widely used and authoritative index of investment yields. The ultimate test of delay compensation is that the owner must receive just compensation.

United States ⟸ 69(5)

**Interest; claims against the United States; rate of interest.**

[11] Pub. L. 93-625, 88 Stat. 2108, gives statutory sanction to the use of a commercial rate index or indicator in determining the rate of interest to be paid by the Government.

United States ⟸ 70(3)

**Patents; infringement; accounting; compensation; delay compensation.**

[12] Delay compensation is part of reasonable and entire compensation and is not considered as interest *per se*.

Patents ⟸ 319(4)

**Patents; infringement; accounting; compensation; delay compensation.**

[13] The determination of a proper amount of delay compensation is a judicial function, the discharge of which requires the exercise of judgment.

United States ⟸ 69(3)

**Patents; infringement; accounting; compensation; delay compensation; measure of.**

[14] In determining reasonable and entire compensation due a patent owner for infringement by the Government, it is inappropriate to calculate delay damages based on the average annual yields of a series of hypothetical long-term Government bonds, since this measure of damages is contrary to the established rule of eminent domain that damages should be determined by what the condemnee has lost, not what the taker has gained. Such yields are not relevant in ascertaining the injury the patent owner has suffered, since the owner is hardly likely to be able to borrow money at the rates the Government can.

United States ⟸ 69(5)

**Compromise and settlement; measure of just compensation for taking.**

[15] A compromise settlement in a taking case is not a judgment of the court, and it is ordinarily not an appropriate measure of just

Syllabus

compensation, at least in the absence of demonstrated acceptance as fair value.

Compromise and Settlement ⇐ 2

**Patents; infringement; accounting; compensation; delay compensation; measure of.**

[16] In determining reasonable and entire compensation due a patent owner for infringement by the Government, the court does not approve calculation of delay damages based on actual costs to the patent owner of borrowing money, since such costs are highly speculative according to a poor or good credit rating.

Patents ⇐ 319(1)

**Patents; infringement; accounting; compensation; delay compensation; measure of.**

[17] In determining reasonable and entire compensation due a patent owner for patent infringement by the Government, the court approves calculation of delay damages on the basis of long-term corporate bond yields as an indicator of broad trends and relative levels of investment yields or interest rates from one period to another, they cover the broadest segment of the interest rate spectrum, and the corporate bond market is large and substantially in excess of long-term Government bonds.

Patents ⇐ 319(1)

**Patents; infringement; accounting; compensation; experimental use.**

[18] *Ordnance Eng'r Corp.* v. *United States*, 84 Ct. Cl. 1 (1936), *cert. denied*, 302 U.S. 703 (1937), and 96 Ct. Cl. 278 (1942), provide no rationale for, or guidance for determining the propriety of, excluding from an accounting under 28 U.S.C. § 1498 so-called "experimental" devices except that they are devices "*built for* experimental purposes." In the present case there is no evidence in defendant's offer of proof that any of the aircraft to which defendant's "experimental use" contentions pertain were built solely for experimental purposes.

Patents ⇐ 319(1)

**Patents; infringement; accounting; compensation; experimental use.**

[19] Use by the Government of the subject aircraft for testing, evaluational, demonstrational or experimental purposes is use by or for the Government and is compensable.

United States ⇐ 69(5)

*J. Edward Shinn*, attorney of record for plaintiff. *John J. McAleese, Jr.* and *William P. Cole*, of counsel.

*B. Frederick Buchan, Jr.* and *Thomas J. Scott*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's and defendant's exceptions to the recommended opinion, findings of fact and conclusion of law, submitted by Judge Donald E. Lane, Associate Judge, United States Court of Customs and Patent Appeals, sitting by designation as Trial Judge in this case, pursuant to 28 U.S.C. § 293(a) and § 2505, in accordance with United States Court of Claims Rule 134(h). In an earlier decision, *Autogiro Company of America* v. *United States*, 181 Ct. Cl. 55, 384 F. 2d 391, 155 USPQ 697 (1967), *rehearing denied*, 184 Ct. Cl. 801 (1968), the court held that some 59 patent claims in 11 patents owned by plaintiff were valid and specific claims were infringed by seven different models of helicopters manufactured for defendant under contracts by Vertol, Hiller, Bell, Kaman and McCulloch. The case is before the court now on (1) the similarity or non-similarity of some 39 models of rotary-wing aircraft to any of the representative models which the court has already held to be infringing, and (2) computation of the reasonable and entire compensation which plaintiff is entitled to recover under 28 U.S.C. § 1498.[1]

The case has been submitted to the court on the briefs and oral arguments of counsel. Upon consideration thereof, since the court agrees with several portions of the trial judge's recommended decision, it adopts (with minor modifications) Part I, *Similarity;* Part III, *Contribution;* Part IV, *Spare Parts;* Part V, *Delay Compensation;* and Part VI, *Experimental Use*. The court also adopts with modification the trial judge's findings of fact, except with respect to royalty compensation, and has made its own findings on that

---

[1] We shall refer to the Autogiro Company as plaintiff, although Stephen Pitcairn, Agent, has been substituted.

subject.[2] We have deleted those parts of the trial judge's recommended decision entitled *Royalty Compensation*, Part II, and *Royalty Adjustment Compensation*, Part VII, and have substituted our own Part II, *Royalty Compensation*, in the modified trial judge's opinion which follows. We have also added our own discussion of *Delay Compensation* to Part V, *infra*, in supplementation of the trial judge's consideration of that subject. The conclusion of law has been changed to reflect our different view of *Royalty Compensation*.

The opinion and conclusion of law of the trial judge, as modified and supplemented by the court, follow:

In *Autogiro Company of America* v. *United States*, 181 Ct. Cl. 55, 384 F. 2d 391, 155 USPQ 697 (1967), *rehearing denied*, 184 Ct. Cl. 801 (1968), some 59 patent claims in 11 patents owned by plaintiff were held to be valid and specific patent claims were held to be infringed by seven different models of helicopters manufactured under contracts for defendant by Vertol, Hiller, Bell, Kaman and McCulloch. In 1973, the Autogiro Company of America was liquidated, and all of its assets, including its claims against the United States, one of which is the subject matter of this action, were transferred to its stockholders who appointed Stephen Pitcairn as their Agent. Pursuant to motion filed January 30, 1974, unopposed by defendant, Stephen Pitcairn, Agent, was substituted for Autogiro Company of America by the court's order filed February 12, 1974.

The parties to this suit agreed that during the accounting phase, both parties would have the right to present evidence as to the similarity or non-similarity between any model of rotary-wing aircraft or part thereof on which no proofs of infringement were offered at the original trial and those models of rotary-wing aircraft on which proofs were offered and which the court in its decision noted above found to infringe any of the patents remaining in suit. The parties have presented such proofs and have presented proofs on various

[2] Though the findings, as modified, are adopted by the court, they are not printed with this opinion because they are so voluminous.

methods of computing the reasonable and entire compensation due plaintiff.

The main issues in the current phase of this litigation are (1) the similarity or non-similarity of some 39 models of rotary-wing aircraft to any of the seven models which the court has already held to infringe one or more valid patent claims, and (2) how to compute the amount of the reasonable and entire compensation which plaintiff is to recover under 28 U.S.C. § 1498, for defendant's unauthorized use of plaintiff's inventions. After over 20 years of litigation, including some 62 trial sessions for the testimony of 57 witnesses on the two present issues, the parties are still poles apart on the end result. Examination of the voluminous record shows that there is little the parties can agree upon except that defendant spent over $639 million, engine costs excluded, in the recovery period, 1946–64, for over 2,200 rotary-wing aircraft.

Defendant now contends that the maximum amount of compensation which this court should allow is $532,279. This represents compensation at a rate of less than 1%, *i.e.*, 0.0832%, on the total procurement cost of $639,257,969. Defendant contends that delay compensation (if any) should be computed at the rates at which the defendant might have borrowed money by hypothetical long term Government bonds, the estimated rates varying from 2.4% to 4.6% per annum, the average being 3.33% for the period 1947–75.

Plaintiff contends that "reasonable and entire compensation" which this court should adopt should include royalties at established rates amounting to $24,570,525, plus delay compensation amounting to $27,851,192 through 1973, plus upward adjustment by $15,034,439 of the royalties to compensate for inflation, plus additional delay compensation for the period 1974 to date of payment, a total of some $67,500,000 plus. The amount sought by plaintiff represents royalty compensation at a rate of 3.85% of the total procurement cost, and delay compensation at rates varying from 4% to 9% per annum, the average being 6.07% for the period 1947–73. The patents, patent claims, and models of rotary-wing aircraft now involved in this litigation are identified in the following table.

Per Curiam

| *Patent Number (and dates of Issue/Expiration)* | *Claims* | *Adjudicated infringing model relative to which similarity proofs were presented* | *Similar models* |
|---|---|---|---|
| 1,948,457 (2-20-34/2-19-51) | 9, 12, 13, 14 & 18 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-1 & HRP-2. |
| 1,990,291 (2-5-35/2-4-52) | 4 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-1 & HRP-2. |
| Do | 4 & 6 | Bell HTL-4 | Bell HTL-1, HTL-2, HTL-3, HTL-5, YH-12B, YH-13, YH-13A, H-13B, H-13D & H-13E. |
| Do | 4 & 6 | Hiller H-23A | Hiller HTE-1. |
| 1,994,465 (3-19-35/3-18-52) | 1, 5, 6, 7, 10 & 13 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-1, HRP-2 & HUP-2. |
| 2,151,215 (2-21-39/3-20-56) | 1, 2, 3, 5, 6, 8 & 9 | Kaman HOK-1 | Kaman HTK-1. |
| Do | 1, 5, 6 & 9 | Kaman HOK-1 | Bell HSL-1. |
| 2,321,572 (6-15-43/6-14-60) | 8, 9, 28 & 29 | Kaman HOK-1 | Kaman HTK-1, HUK-1, H-43A & H-43B. |
| 2,339,836 (1-25-44/1-24-61) | 1 | Kaman HOK-1 | Kaman HTK-1, HUK-1, H-43A & H-43B. |
| 2,344,966 (3-28-44/3-27-61) | 1 | Kaman HOK-1 | Kaman HTK-1, HUK-1, H-43A & H-43B. |
| 2,344,967 (3-28-44/3-27-61) | 1, 2, 3, 4, 13 & 18 | Kaman HOK-1 | Kaman HTK-1, HUK-1, H-43A & H-43B. |
| 2,380,582 (7-31-45/7-30-62) | 6–9, 12, 13, 16 & 17 | Bell HSL-1 | None. |
| Do | 1–5, 7–9, 12, 13, 16–21 | McCulloch MC-4C | McCulloch YH-30. |
| Do | 1–5, 7–9, 12, 13, 16–21 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HUP-2 & HUP-3 (H-25A). |
| | 1, 2, 3, 5, 7, 8, 9, 12, 13, 16, 19, 20 & 21. | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-1. |
| Do | 1–5, 7, 8, 12, 16, 18, 19, 20 & 21. | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-2. |
| Do | 1, 3, 4, 5, 16, 17, 18, 19 & 20. | Vertol/Piasecki HUP-1 | Vertol/Piasecki YHC-1B (YHC-47A), HC-1B (CH-47A). |
| Do | 1–5, 7–9, 12, 13, 16–21 | Vertol/Piasecki H-21B | Vertol/Piasecki YH-21, H-21A, H-21C & H-21 (V-44). |
| Do | 1, 3, 4, 5, 16, 17, 18, 19 & 20. | Vertol/Piasecki H-21B | Vertol/Piasecki YHC-1A, HRB-1 (CH-46A). |
| Do | 1–5, 19 & 20 | Vertol/Piasecki H-21B | Bell YH-40, HU-1, HU-1A, HU-1B & YHU-1D. |
| Do | 1–5, 19 & 20 | Vertol/Piasecki H-21B | Cessna YH-41 & CH-1C. |
| Do | 1–5, 16, 18, 19 & 20 | Vertol/Piasecki H-21B | Gyrodyne DSN-1 & DSN-3. |
| Do | 1, 2, 3 & 5 | Vertol/Piasecki H-21B | Kaman HU2K-1. |



242-469—78——13

Per Curiam

| Patent number (and dates issued/Expiration) | Claims | Adjudicated infringing model relative to which similarity proofs were presented | Similar models |
|---|---|---|---|
| 2,380,583 (7-31-45/7-30-62) | 56, 59, 60, 64 & 65 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HUP-2 & HUP-3 (H-25A) & HRP-1. |
| Do | 56, 60, 64 & 65 | Vertol/Piasecki HUP-1 | Vertol/Piasecki HRP-2. |
| Do | 56, 59, 60, 64 & 65 | Vertol/Piasecki H-21B | Vertol/Piasecki YH-21, H-21A, H-21C, H-21 (V-44A) YHC-1A, HRB-1 (CH-46A), YHC-1B (YHC-47A) & HC-1B (CH-47A). |
| Do | 59 & 60 | Vertol/Piasecki H-21B | Kaman HOK-1, HUK-1, H-43A & H-43B. |
| Do | 60 | Vertol/Piasecki H-21B | Gyrodyne DSN-1 & DSN-3. |
| Do | 60 | Vertol/Piasecki H-21B | Cessna YH-41 & CH-1C. |
| Do | 62 | McCulloch MC-4C | McCulloch YH-30, Cessna YH-41 & CH-1C. |
| Do | 62 | McCulloch MC-4C | Kaman HU2K-1. |
| 2,421,364 (5-27-47/5-26-64) | 33, 44 & 45 | Kaman HOK-1 | Kaman HTK-1, HUK-1, H-43A, H-43B & HH-43B. |

Per Curiam

## I. *Similarity*

The order of the trial judge filed April 17, 1969 provided:

> (1) In the proceedings herein under Rule 47(c)(2), neither party shall challenge the determinations of infringement, the validity, or the scope as construed by the court, of any claim found by the court to be valid and infringed in *Autogiro Company of America* v. *United States*, 181 Ct. Cl. 55, 384 F. 2d 391 (1967), and
>
> (2) The decision whether "other specified types or models of aircraft or parts thereof, procured by defendant" are infringing aircraft or parts for which defendant is liable shall be based on proofs of "similarity or non-similarity" of construction and mode of operation between (a) such other aircraft or parts and (b) those found by the court to infringe. *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1 (1942); *Fauber* v. *United States*, 112 Ct. Cl. 302 (1948).

Neither party requested review or modification of that order.

The evidence relating to the similarity or the identity between adjudicated infringing models and the additional assertedly similar models consisted of comparison of the pertinent structures and the operation of the adjudicated infringing helicopters with the corresponding structure and the operation of the assertedly similar models. That proof-procedure is in accord with the principles enunciated by this court in *Marconi Wireless Telegraph Co.* v. *United States*, 99 Ct. Cl. 1, 53 USPQ 246 (1942), *modified*, 320 U.S. 1, *order on remand*, 100 Ct. Cl. 566 (1943).

Plaintiff's similarity proofs could have been limited to the subject matter of but a single claim of each of the patents in suit found valid and found to be infringed by the adjudicated models, thereby establishing the required proof of similarity in reference to the subject matter. The plaintiff's proofs were not so limited. The patent claims in suit are of varying scope and it is not required that "similarity" be established as to a given structure in respect to *all* claims of varying scope as found to be infringed. By the same token, the scope of the royalty base for the various patent claims in suit varies in accordance with the scope of the claimed subject matter. In view of the unchallenged and uncontradicted evidence establishing similarity, and in most instances the identity, as to

the assertedly similar structures, and in view of the paucity of any credible evidence of non-similarity, plaintiff's assertions on similarity are found to be fully supported by the record.

## II. *Royalty Compensation*[3]

The use or manufacture by or for the Government of a device or machine embodying any invention protected by a United States patent, is a taking of property by the Government under its power of eminent domain. The nature of the property thus taken is a license in the patent, the claimed invention of which is used or manufactured by or for the Government, and such license continues throughout the life of the patent, or the period of the infringing procurement, whichever is shorter.

As this court recently stated in *Calhoun* v. *United States*, 197 Ct. Cl. 41, 51, 453 F. 2d 1385, 1391, 172 USPQ 438, 443 (1972):

> * * * The theory underlying a patent suit in this court pursuant to that section [1498] is that the Government, when a patented device or invention is made or used by or for the United States, *ipso facto* takes by eminent domain a compulsory compensable license in the patent; the patentee obtains his Fifth Amendment just compensation for that taking through his action here under § 1498. * * *

*See*, *Waite* v. *United States*, 282 U.S. 508 (1931); *Crozier* v. *Krupp*, 224 U.S. 290 (1912); *Irving Air Chute Co.* v. *United States*, 117 Ct. Cl. 799, 93 F. Supp. 633, 87 USPQ 246 (1950).

The first step in determining reasonable compensation is to ascertain when the "taking" occurred. We are guided in this by our prior decision in *Irving Air Chute Co.*, *supra*. The Government there urged that if it manufactured or used any devices covered by any of plaintiff's patents more than six years before the petition was filed, the cause of action should be barred by the statute of limitations. The Government argued that by using or manufacturing a patented article, it acquired a license to continue to manufacture or

[3] This part has been substituted for the similarly titled portion of Judge Lane's opinion. Only the Chief Judge, Judge Davis and Judge Skelton join in the discussion contained in this part II of the opinion. However, Judges Nichols and Kunzig concur in the result of this part of the opinion.

use the article for the duration of the patent, that the taking occurred once and for all with this first unauthorized use. Plaintiff urged that it should be able to recover for articles manufactured within six years of the date of the filing of its petition, even as to patents covering devices manufactured by or for the Government more than six years before the petition was filed. We explained that "The statute, 28 U.S.C. § 1498 * * * does not tell us, expressly, whether only one cause of action, or several, will accrue from a succession, perhaps with long intervals between, of manufactures or uses by the Government." 117 Ct. Cl. at 804, 93 F. Supp. at 636, 87 USPQ at 248. Since it was not possible to ascertain the scope and duration of the interest taken at the time of the first unauthorized use, we held in *Irving Air Chute* that the cause of action did not accrue at the first taking for all future acquisition by the Government. *See also*, *Coakwell* v. *United States*, 178 Ct. Cl. 654, 372 F. 2d 508, 153 USPQ 307 (1967); *Regent Jack Mfg. Co.* v. *United States*, 167 Ct. Cl. 815, 337 F. 2d 649, 143 USPQ 136 (1964); *Gage* v. *United States*, 122 Ct. Cl. 160, 103 F. Supp. 1022, 93 USPQ 103, *cert. denied*, 344 U.S. 829 (1952). So too in the instant case.

The trial judge refused to consider transactions occurring after November 8, 1946, in establishing the reasonable royalty because he deemed that they were not material, as a matter of law, since they took place after the date of the first infringement by defendant. The trial judge determined that the defendant's first unauthorized use of plaintiff's patents, on or about November 8, 1946, constituted a taking, all at once, of plaintiff's entire property. This analysis runs contrary to *Irving Air Chute*, which we think was correctly decided. The takings occurred whenever the Government procured or used a device covered by any of plaintiff's patents without a license. Our analysis accords, not only with *Irving Air Chute* but also with the terms of 28 U.S.C. 1498, which provides in part: "*Whenever* an invention described in and covered by a patent of the United States is *used or manufactured* by or for the United States without license of the owner thereof or lawful right to use or manufacture the same, the owner's remedy shall be by action against the United States in the Court of Claims for the recovery of his

reasonable and entire compensation for *such* use and manufacture." (Emphasis added.)

The recovery period runs from November 1946, when the Government first infringed one of the patents in suit, until late in May 1964, the expiration date of the last patent involved. It is not easy to fix upon appropriate royalties for the takings during that long time-span, but we think it can be done with fairness to both parties.

The evidence shows that Autogiro received patent royalties under some nine licenses during the period (1932–1946) before the years now at issue. Some were at a 5% rate, some at 7% and some at an .85% nominal wartime rate.[4]

We put aside the wartime rate, both because it preceded the years with which we are here concerned, and also because the particular circumstances of the wartime procurement of patent licenses make it very difficult to equate the very low-level wartime rate with fair market value for the post-war period or with an established post-war license policy.[5]

---

[4] In 1930, plaintiff licensed Kellett Aircraft Corp. at the rate of 6% of retail sale price of the complete aircraft. This rate was changed to 5% during 1932–45. The Government procured rotary-wing aircraft from Kellett in the period prior to World War II and approved payment of the 5% royalty thereon to Autogiro. Pitcairn Autogiro Company was licensed during 1936–41 at the 5% rate. Pitcairn-Larsen Autogiro Company was licensed in 1941 at the rate of 5% of the retail sale price of the complete aircraft or at 7% of the sale price if sold without engine or standard equipment. A.G.A. Aviation Corporation was licensed 1941–43 at the same 5% and 7% rates. The Firestone Tire and Rubber Company was licensed by the plaintiff in 1943–46 at the same 5% and 7% rate subject to a sliding scale. Firestone was again licensed about March 12, 1946, as of September 1, 1944, at the rate of 10% of the retail sale value of the patent components, *i.e.*, a per patent royalty, but with a royalty ceiling of 5% of the total retail sale value of the complete aircraft and spare parts, and subject to a sliding scale which reduced the rate as royalties exceeded stated amounts. The sliding scale provided that for the first $50,000 of royalties, the sum of the per patent royalties applicable to each such complete helicopter and spare parts therefor but not to exceed 5% of the total sale value; for the next $45,000 of royalties 9/10s of the initial rate; for the next $40,000 of royalties 8/10s of the initial rate. The license taken by Firestone in March of 1946 was offered at the same rates to other manufacturers of rotary-wing aircraft.

[5] In 1943, the plaintiff unilaterally selected and proffered to the Government and to industry a nominal wartime royalty rate of .85% of the contract price of the aircraft. Since the Royalty Adjustment Act of 1942 (Act), 56 Stat. 1013, later codified as 35 U.S.C. §§ 89–96 (1946 ed.), was in effect at that time, the Government could have reduced the rates by order if plaintiff had not been cooperative. Pursuant to that Act, any department or agency which ordered the manufacture or use of an invention could fix royalty rates which were deemed fair and just, taking into account the conditions of wartime production, if it believed that the rates provided by existing licensing agreements were unreasonable or excessive. The licensor's sole remedy was a suit to recover the

(Continued)

Likewise, we reject the pre-war rates as proper guidelines for the post-war period because, in our view, plaintiff itself established, roughly contemporaneous with the beginning of the recovery period, a new post-war rate, for general use, which it deemed satisfactory to it.[6] Effective as of January 1, 1947, Autogiro entered into an agreement with United Aircraft Corporation for a royalty of $500 an aircraft for 1946–1948, with the $500 ceiling to change to 2% of the total retail sale value (including engine and standard equipment) on and after January 1, 1949.[7] After this United agreement was executed, the plaintiff proposed similar licenses to other major manufacturers of helicopters, in effect announcing its post-war rate to be 2%. These companies all refused to take licenses but the significant fact is that plaintiff made the offer and made it widely. In 1949, after some months of negotiation triggered by United's disinclination to let the 2% rate go into effect, plaintiff granted United a paidup license at considerably less than 2% per aircraft. These two United licenses were the only ones actually made by Autogiro during the recovery period from November 1946 to May 1964. But as we have said plaintiff did make a general offer in 1947, at the 2% figure, to other manufacturers. That proffered rate was neither increased nor lowered before suit was brought here in 1951 (after which everyone concerned awaited the end of the litigation).

It has been suggested on behalf of the plaintiff that the 2% figure cannot serve as an established royalty rate used by the patentee in commercial licensing (*see* the test set forth in

(Continued)
difference between the royalties fixed and specified by the agency and the royalties found by the court to be fair and just compensation. Act §§ 1–2. Further, the head of any Government agency was authorized to enter into agreements and settlements in compromise of any claim by any inventor or licensor. Act § 3. Plaintiff granted wartime licenses, which covered all of plaintiff's patents including the patents here in suit, to Nash-Kelvinator Corporation, United Aircraft Corporation and Kellett Aircraft Corporation. These wartime licenses were at the rate of .85% of the contract price for rotary-wing aircraft made for and sold to the Government and these licenses expired on March 2, 1946, *i.e.*, 6 months after the cessation of hostilities.

[6] We include in the war and pre-war category the Firestone agreement, made in March 1946 as of September 1944 (*see* note 4, *supra*), since very early in the recovery period that license (which predated the recovery period) was definitely superseded, as plaintiff's general policy, by the 1947 United Aircraft agreement. *See* the text immediately *infra*.

[7] The agreement could be terminated at any time after December 31, 1948, upon the giving of a six-months written notice.

*Calhoun* v. *United States*, 197 Ct. Cl. 41, 55–56, 453 F. 2d 1385, 1393–94 (1972)) because (a) the first (1947) United agreement was mainly the product of compromise to avoid litigation, and (b) mere offers by the patentee are inadmissible to prove value. We can accept neither premise.

The record does not show that the 1947 United License was a one-sided effort by United to force Autogiro to compromise its true position or face years of grinding litigation in this court under 28 U.S.C. § 1498.[8] Whatever it may now say,[9] plaintiff does not seem at all to have made that evaluation of the United agreement at the time it was signed. In a letter of October 1948 to Harold Pitcairn (president of Autogiro), one of Autogiro's patent counsel (Raymond Synnestvedt) wrote about a recent visitor whose "main purpose was to sound me out on whether the Autogiro Company might grant him a license—and what the current licensing terms are. Since written outlines of the present licensing terms have been distributed fairly widely, I saw no reason why I should not orally outline the terms to [the visitor], which I did. He had not heard of the reduction from the previous ceiling of 5% to the postwar ceiling of 2%, and I think he was quite interested." Again (as indicated above), Autogiro gave an outline of a proposed license agreement with a 2% ceiling to three manufacturing companies, with the royalty rates described as "being quite representative of what is currently being offered." [10] These statements give not the slightest hint that Autogiro felt that the United agreement (or the like agreements proffered to the other manufacturers) was unfair or afforded it less than its due in the period now at issue.

It is a truism that patents can change or decline in value, and that seems to have been the case for Autogiro, even in its own eyes, during the post-war years. It wanted a package deal for any and all of its patents, and some of these were

[8] The defendant was by far the largest consumer of products embodying plaintiff's inventions and had refused in 1947 to enter into license agreements, preferring to rely on indemnity agreements from its suppliers.

[9] At trial, Autogiro's patent counsel testified that the cost, trouble and worry of litigation were factors in reducing the royalty rate to 2% in 1947.

[10] 4 *Nichols, Eminent Domain* (3d ed. rev. 1975), § 12.311 [2], declares that statements made in the process of making an offer concerning facts in the controversy which are not mere concessions made for the purpose of such offer are admissible against the party making them.

expiring from time to time. Engineering data for autogiros (manufactured in the pre-war era) were not useful for helicopters (the article made after the war). The post-war procurement of devices using plaintiff's inventions was bound to be very much larger than the pre-war purchases—and the royalty *rates* could therefore decline significantly. Nor is it a sign of invalidating compromise that, especially where a packet of patents is involved, there may have been some doubts as to the validity of some of the claims.[11] Autogiro probably had some of those doubts itself and adjusted its demands accordingly. For these reasons the 2% United agreement seems to us highly probative under the rule we reiterated in *Calhoun* v. *United States*, 197 Ct. Cl. 41, 55–57, 453 F. 2d 1385, 1393–94 (1972). *Calhoun* teaches that the mere surmise that a bargained license may possibly include some discount for litigation-avoidance does not *per se* preclude use of an accepted commercial rate as establishing reasonable and entire compensation. Earlier, *Saulnier* v. *United States*, 161 Ct. Cl. 223, 314 F. 2d 950 (1963), took heavy account, in setting compensation, of the plaintiff's previous settlement of infringement claims against the British gov-

[11] After the 1947 agreement but before the 1949 paid-up license, a United official wrote (in July 1948) to the president of Autogiro:

"The agreement as concluded provided, however, for an increase in royalty ceiling to 2 percent of retail sales value for the calendar year 1949 and succeeding years. United signed the license agreement with the expressed intention of reviewing the entire situation, with special reference to royalty rates, prior to assuming any obligation for royalties in 1949 or subsequent years.

"From the beginning, United's problem has been to determine what royalty, if any, it was warranted in paying under the Autogiro patents, in order that United might be free from possible litigation from that source in carrying forward its research, experimental and manufacturing programs. In this connection, since by far the greater part of our sales of helicopters for some time to come will be to the Government, any suit involving such sales would have to be brought against the Government in the Court of Claims.

"In each appraisal of the patent situation, royalty rates have been opposed to the possible results, both favorable and unfavorable, of litigation should we proceed without a license. Each successive appraisal has resulted in a lesser value to be placed upon Autogiro's patents, and we would fully expect this trend to continue in the future. As you know, United has never felt the need of engineering assistance from Autogiro and it has never received, nor does it contemplate receiving in the future, any such assistance."

It is to be noted that this letter was written over a year *after* the 1947 agreement became effective, and cannot retroactively turn that 1947 pact into a mere compromise-to-avoid-litigation, especially in view of Autogiro's clear acceptance of, and satisfaction with, the 1947 agreement.

ernment where that settlement appeared to be satisfactory and reasonable. *See* 161 Ct. Cl. at 226–27, 314 F. 2d at 951–52.

As for the offers not translated into actual agreements, the authorities which reject such use (*see* the cases cited in 4 *Nichols, Eminent Domain* (3d ed. rev. 1975), §§ 12.311[2] and 12.3113[3]) concern attempts by the condemnee to seek a *higher* award on the basis of offers made by or to him (or to utilize a third-party offer with respect to comparable property to gain a *higher* award). They do not involve an effort by the condemnor to rely on an offer made *by* the condemnee as proof of the value of the property. It is obvious that, although the inherent defects of offers made *by* condemnee-owners prevent the opposite party, the condemnor, from being bound by such offers, there is no reason why the owner himself should not be held to his own offer. In this instance, the post-1946 offers were not casual or *ad hoc* but were circulated "fairly widely" in the industry. It is appropriate to take them into account and to give them great weight.[12]

All this means that the post-1946 United agreement at 2% as well as the post-1946 offers made by Autogiro at that same level—plaintiff's own position deliberately taken in 1947 and 1948—have a *prima facie* title to acceptance as the reasonable royalty for 1946–1964. The question remains whether the royalty should be set at a still lower figure, as defendant requests. This is not a simple skein to unravel, but our conclusion is that the 2% rate should be accepted for all infringements (after 1948, *see* note 16). The main reason is that, quite unlike the 2% figure, there is no indication from Autogiro that any lesser royalty was ever satisfactory, acceptable, or offered generally. The patentee's situation was unusual in that the Government was the dominant consumer of the articles embodying the patents, and this put the plaintiff to a disadvantage since it was very unlikely that an injunction

[12] There is no support for the view that, until six months after the Japanese Peace Treaty in April 1952, the plaintiff's licensing terms would be influenced by the Government's theoretical right to fix war-time royalties under the Royalty Adjustment Act of 1942. Plaintiff's own statements give no intimation of this nor does the record suggest that this theoretical power had any real impact after the actual end of the World War II hostilities in 1945–1946. It should also be added that the Adjustment Act's standard was fair and just compensation, and it cannot be assumed without proof that the mere naked existence of that statute had such a depressing effect. *Cf. United States* v. *Commodities Trading Corp.*, 339 U.S. 121 (1950).

could be obtained against United (or other infringers).[13] We therefore discount, in the absence of any expression of contentment, Autogiro's granting to United, at the latter's strong insistence, of a paid-up license in 1949.[14] No offers to other companies, stemming from this paid-up license, were made by plaintiff.[15] The theoretical constructions of defendant's expert—who reached a figure which was only a fraction of 2%—were based in largest part on the paid-up license; the expert did not consider plaintiff's hobbled position in trying to determine what the "parties might well have agreed upon" (*Saulnier* v. *United States*, *supra*, 161 Ct. Cl. at 227 (1963)) if Autogiro had been relatively free of this one-sided litigation pressure. For the present case, in which there was only one actual licensee during almost the entire span of the infringement years, and this suit began early in the recovery period, the best that we can do is to accept the only royalty rate "offered freely [by Autogiro] to everyone" in the industry during that period, a rate actually agreed to, for a time, by United, the largest manufacturer. *See Calhoun* v. *United States*, *supra*, 197 Ct. Cl. at 56, 453 F. 2d at 1394.[16]

## III. *Contribution*

Defendant's requested findings of fact assert that the order of magnitude of the contribution of each of the patents in suit to the rotary-wing aircraft industry is "zero, minimal, or negative." Defendant bases such requested findings primarily on a rehash of the several patent application

[13] We refer to the fact that a patentee cannot obtain an injunction against a government-supplier or government-contractor and is confined, for his exclusive remedy, to a suit for "reasonable and entire compensation" (*i.e.* monetary compensation) against the United States under 28 U.S.C. § 1498. These suits generally take a long time to come to their conclusion and the patentee, even if he prevails, normally obtains no compensation until the litigation is at an end. (The reference is not to the Royalty Adjustment Act, *see* note 12, *supra*.)

[14] *See* note 11, *supra*.

[15] Suit was brought here in 1951, and it seems clear that after that date the problem of plaintiff's compensation would be, and was, left to the result of the litigation.

[16] For the period before 1949, the 1947 United agreement provided that the royalty on any one aircraft should not exceed $500, and also that from 1947 onward the minimum royalty per year should be $10,000. We consider these provisions of that agreement to be applicable to this case, though the only one that is likely to be operative is the $500 ceiling for aircraft used by or manufactured for the defendant prior to January 1, 1949. From January 1, 1949, the 2% rate applies.

files and the prior patents cited therein. The court has already found specific patent claims valid and infringed by one or more of seven helicopter types procured by defendant. The weight of the evidence shows that such prior art items are either totally irrelevant to the subject matter of the patent claims in suit or are fundamentally deficient, impractical and/or inoperative. There is no credible evidence that the helicopters made for or used by the defendant might have been more satisfactory if plaintiff's patented inventions had not been incorporated therein. Defendant's contention that royalty compensation should be computed at rates of less than 1%, based on its contention that plaintiff's contributions to the industry were minimal, is without merit.

### IV. *Spare Parts*

The United license defines "Licensed Aircraft" as not only "aircraft with sustaining rotors * * * embodying or manufactured or operating according to any or all of the inventions covered by Patents of Autogiro," but also "parts and assemblies of parts embodying or manufactured or operating according to any or all of said inventions for use in such aircraft. * * *" With regard to spare-part rotor hub assemblies for the HUP–1 helicopter, in accord with plaintiff's per-patent royalty the royalty base for claim 14 of the '457 patent is each spare-part HUP–1 rotor hub assembly, and the royalty therefor would be 10% of its retail sale value. However, spare-part rotor hub assemblies which embody or which are manufactured according to the subject matter of claim 14 of the '457 patent are, *per se*, Licensed Aircraft, *i.e.*, parts "for use in" the Government's infringing helicopters for which such spare-part hub assemblies are procured; and in accord with the 2% royalty ceiling provision of plaintiff's established royalty for Licensed Aircraft, the total royalty for such spare-part hub assemblies may not exceed 2% of their retail sale value. The foregoing comments are equally applicable in respect to the effective 2% royalty for spare-part rotor hub assemblies for the HRP–1 and HRP–2 helicopters.

Plaintiff has limited its requests for royalties on all spare-part Vertol, Kaman and Gyrodyne rotor blades which are

within the scope of this accounting, to the subject matter of claim 60 of the '583 patent as held to be infringed by either the HUP–1 or the H–21B rotor blades, and that subject matter is also the basis for plaintiff's requests for royalties on the rotor blades as installed on the Gyrodyne DSNs. Defendant's contentions concerning claim 65 of the '583 patent and the various features thereof, with respect to recovery of royalties for spare-part rotor blades are completely moot at this point. The various features of claim 65, none of which are included in claim 60, and to which defendant has referred, are totally immaterial to the determination of plaintiff's right to recover royalties for spare-part rotor blades with respect to the subject matter of claim 60 as held to be infringed. Defendant's contention that plaintiff is not entitled to royalties for spare-part hub assemblies and rotor blades is without substance.

## V. *Delay Compensation*

### A.

The "reasonable and entire compensation" due plaintiff under 28 U.S.C. § 1498 includes not only reasonable royalties but also an appropriate amount which compensates plaintiff for defendant's delay in payment of those royalties. This additional amount has been referred to as "delay compensation." As stated by Justice Holmes in *Waite* v. *United States*, 282 U.S. 508, 509 (1931), the "reasonable and entire compensation" provided by the statute "was intended to accomplish complete justice as between plaintiff and the United States." The amount due as delay compensation is determined by multiplying the annually accrued royalties by an appropriate annual percentage rate. The periods of time covered by the computation of that additional amount extend from the dates of defendant's procurements until the date of payment of the court's judgment herein.

The amounts heretofore awarded as delay compensation by this court in eminent domain cases, including cases under 28 U.S.C. § 1498, have been computed at various rates. From 1927–37 the rate was 6%. During 1937–44 the rate was 5% and after 1944 the rate of 4% has been used. In the court's

decisions in those earlier cases there is little or no discussion of the theory or basis upon which a particular percentage rate of delay compensation was chosen.

The rates used by the court in the past to calculate delay compensation have generally followed trends of changes in investment yield rates during the 1920's, 1930's and 1940's. The rate to be used during the delay compensation periods involved in this suit, *i.e.*, from 1946 until payment of the court's judgment herein, should also follow the changes in yield rates. These may be determined by reference to an established, well recognized, widely used and authoritative index of investment yields. Plaintiff urges that the court use for this purpose Moody's Composite Index of Yields on Long Term Corporate Bonds.

Defendant has urged that the court should establish, as the rate of delay compensation due plaintiff, an amount equal to the average annual yields on a series of hypothetical long term Government bonds which defendant constructs subjectively. Both plaintiff and defendant thus urge that a varying rate of delay compensation should be established by the court in this case. However, defendant's position is that the various rates of delay compensation should be established without reference to the court's own varying rates of delay compensation in prior periods, and defendant ignores any relationship between the rates it now proposes and the rates of delay compensation which this court has used just prior to the beginning of the accounting period in this case. Both parties recognize that the 4% annual rate of delay compensation which was applied by this court after 1944 should not arbitrarily be continued in this case. Both parties agree that the court should establish a varying annual percentage rate for delay compensation which is appropriate under the facts and circumstances in this case. The parties disagree on the principles which determine an appropriate varying rate, and on the varying rate itself. The amount due as delay compensation in this case involves a determination by this court of an appropriate base or yardstick by which to measure and thereby establish the award for delay compensation. The method of determining delay compensation should be justified by the evidence, and the rate should be responsive to the

ends of justice. The ultimate test, of course, is that the plaintiff must receive just compensation.

Examination of evidence of record relating to the trends indicated by Moody's Composite Index of Yields on Long Term Corporate Bonds leads to the conclusion that in view of all the circumstances involved in this prolonged litigation, it is reasonable to divide the delay period into several periods and to utilize a rate of 4% for the period 1947–55, a rate of 4½% for 1956–60, a rate of 4¾% for 1961–65, a rate of 6½% for the period 1966–70, and a rate of 7½% for the period 1971–75. It is noted that Pub. L. No. 93–625, § 7, 88 Stat. 2108, signed by the President on January 3, 1975, now provides for the payment of interest by the Government at the rate of 9% per annum on overpayments of federal internal revenue taxes, effective July 1, 1975. Said law also provides for annual adjustment of the interest rate when the prime rate charged by banks during September is at least a full point more or less than the Government interest rate then in effect. The Congress thus gives statutory sanction to the use of a commercial rate index or indicator in determining the rate of interest to be paid by the Government.

Plaintiff has urged that the delay compensation should run from the mid-point of each year during the accounting period since the actual procurement dates for the many aircraft involved in this case are scattered throughout each calendar year. In *Calhoun*, *supra*, the court selected August 15, 1954, mid-point of the period from April 29, 1954 to November 21, 1956, for the start of delay compensation. In *Amerace Esna Corp.* v. *United States*, 172 USPQ 305, 308 (1972), the trial judge selected March 8, 1955, mid-point of the period September 8, 1952 to September 8, 1958, for start of delay damages. The court adopted that computation in a *per curiam* opinion reported at 199 Ct. Cl. 175, 462 F. 2d 1377, 174 USPQ 517 (1972). In *Breese Burners, Inc.* v. *United States*, 140 Ct. Cl. 9, 115 USPQ 179 (1957), the court decided that interest would run from December 31 of each year involved until date of payment. In *Badowski* v. *United States*, 150 Ct. Cl. 482, 278 F. 2d 934, 125 USPQ 656 (1960), the court held that reasonable and entire compensation should include interest to date of payment to compensate plaintiff for the

delay in payment. In *van Veen* v. *United States*, 181 Ct. Cl. 884, 386 F. 2d 462, 156 USPQ 403 (1967), the court held that plaintiff was entitled to recover interest as part of just compensation from January 1, 1967 to the date of payment. Defendant objects to the allowance of interest from the midpoint of each calendar year and asserts that the acceptance date of each infringing aircraft is available. Plaintiff's license agreement with United in 1947 provided for the payment of royalties semi-annually within 45 days after June 30 and December 31 of each year on all licensed aircraft sold, leased or put into use during the preceding 6-month period. In view of all the circumstances involved in this litigation, it is concluded that reasonable delay compensation herein should be computed on a calendar year basis with interest starting on January 1 of each year on the royalties accrued during the preceding calendar year. Delay compensation is part of reasonable and entire compensation and is not considered as interest *per se*.

Defendant's debtor theory that delay compensation should be based on the yields on a series of hypothetical Government bonds was recently rejected by one of the court's trial judges in *Arcata National Corp.* v. *United States*, No. 771–71, report filed July 25, 1974. The trial judge in that case concluded that delay compensation should be paid for the period involved at the rate of 6.6% simple annual interest, a rate based on his reference to corporate AAA bond interest rates and prime interest rates. A stipulated settlement based thereon was confirmed by order of the court on January 3, 1975, *Arcata National Corp.* v. *United States*, 206 Ct. Cl. 819. The court's order entered judgment for Arcata in the sum of $35,882,251.50 together with simple interest thereon at the rate of 6.6% per annum until date of payment.

After considering all the circumstances involved in the present protracted litigation it is concluded that delay compensation computed at the varying rates for varying periods set out above is both reasonable and justified. The determination of a proper amount of delay compensation is a judicial function. The discharge of that function requires the exercise of judgment.

Plaintiff has presented evidence of the expenditure of $1,669,658 during the period 1951–73 for attorneys' fees, witness fees and other expenses allocable to the 11 patents which the court has held valid and infringed. But plaintiff did not include attorneys' fees in his requested reasonable and entire compensation before the trial judge, and no determination with respect to attorneys' fees, witness fees and expenses is called for from the court.

B.[17]

As indicated in subpart A, *supra*, the trial judge has recommended delay compensation based on a stepped percentage rate varying from 4% for the years 1947–55 up to 7½% for the years 1971–75. The trial judge determined these percentages after examining the trends in investment yields, as indicated by Moody's Composite Index of Yields on Long Term Corporate Bonds. The trial judge noted that in many cases the court awarded delay compensation at a rate of 6% during the period 1927–37, 5% during the period 1937–44, and 4% during the period 1945–48, which rates were about 1 to 2 percentage points higher than the long term corporate bond yields during the same periods. The Government urged the trial judge and the court to calculate delay damages based on the average annual yields of a series of hypothetical long term Government bonds, in effect, the cost to the Government of borrowing money. This measure of damages is contrary to the established rule of eminent domain that damages should be determined by what the condemnee has lost, not what the taker has gained. 3 *Nichols, Eminent Domain*, (3rd Ed. Rev. 1975), § 8.61:

> The just compensation to which an owner is entitled when his property is taken by eminent domain is regarded in law from the point of view of the owner and not of the condemnor. In other words, just compensation in the constitutional sense is what the owner has lost, and not what the condemnor has gained.

(Fn. omitted citing, *e.g. Boston Chamber of Commerce* v. *Boston*, 217 U.S. 189 (1910, per Holmes, J.)) The yield on a

[17] This subpart B of Part V of the opinion has been added by the court.

series of hypothetical Government bonds is not relevant in ascertaining the injury plaintiff has suffered. It measures compensation only according to the point of view of the taker without reference to that of the owner since he is hardly likely to be able to borrow money at the rates the Government can.[18] *King* v. *United States*, 205 Ct. Cl. 512, 504 F. 2d 1138 (1974), does not require a different result. *King* turns on its facts and we do not extend that decision here. The parties in *King* stipulated that the interest rate awarded should be commensurate with the rates of interest paid by the Government in the market for its own borrowing purposes. Plaintiffs urged an interest rate of 6%, whereas the Government proposed a rate of 4%. The trial judge, *in view of the special circumstances of the case*, that is, the parties' stipulation described above, recommended an award based on the annually fluctuating rate on long-term United States Government bonds, which ranged from 3.95% in 1962 to 5.70% by the end of 1970. The court adopted the trial judge's recommended award in a *per curiam* opinion. It is clear that the use of the rate of interest on long-term Government bonds as a method of determining interest as part of just compensation rests on the stipulation and not on the independent determination of the court.

The court has considered *Arcata National Corporation* v. *United States*, (order reported) 206 Ct. Cl. 819 (1975), for two reasons: first, Judge Lane mentions it in his recommended decision (*supra*, subpart A) as a case in which the

[18] *United States* v. *Blankinship*, 543 F. 2d 1272 (9th Cir. 1976), is not to the contrary. It dealt with relatively short-term, actual Treasury securities—not with hypothetical long-term Government bonds never actually issued. The Court of Appeals held that the trier had to consider and take into account such short-term *actual* Government obligations (not that the trier was bound by those rates). In the present case, in contrast, the defendant emphasized and emphasizes hypothetical very-long-term securities, "constructed" by the defendant for the purposes of this litigation. Judge Lane had before him, in addition to defendant's construction of hypothetical long-term Government bonds, record evidence of shorter-term, actual Government obligations of the type dealt with in *Blankinship*—and he clearly took these latter into account. *See* the last three sentences of court finding 478 (trial judge finding 526): "One-year Government bonds produce an annual average simple interest equivalent rate of 6.91 percent average for the period 1946–1975. An average equivalent rate of 6.28 percent is produced by using 4-year Government bonds (the average of yield statistics for 3- to 5-year Government bonds). The delay compensation asserted by defendant, an average equivalent rate, from defendant's hypothetical long term Government bonds, of 3.10 percent, is both inadequate and improper."

trial judge rejected defendant's theory that delay compensation should be based on the yields of a series of hypothetical Government bonds, and, second, that trial judge awarded a 6.6% covering a period for part of which Judge Lane awarded 7.5%. The trial judge in *Arcata* recommended an award which included 6.6% for delay damages (No. 777–71 decided July 25, 1974), but the court subsequently, by order accepted a stipulation of the parties that plaintiff's written offer of settlement with 6.6% interest had been accepted. *Arcata* is not a judgment of the court, but is a compromise settlement, and as such, it is not an appropriate measure of just compensation. 4 *Nichols, Eminent Domain*, (3rd Ed. Rev. 1975) § 12.3113 [2].

In *Arcata*, the Government urged that interest at a rate of 6%, the statutory rate, 16 U.S.C. § 79c(b)(2), satisfied the requirements of just compensation, relying on the fact that on or about October 2, 1968, the taking date, the Government was paying 6% on its debt obligations. Plaintiff sought to recover interest at a rate of 7.36%, representing the average rate of interest it actually incurred on its debt obligations from the date of taking to a date just before trial. The parties recognized that ascertainment of just compensation was a judicial function and thus the court was not limited to the statutory figure of 6%, in effect, that the statutory 6% figure in the Redwood National Park Act, 16 U.S.C. § 79a–79j, was not binding. The trial judge rejected defendant's method as being too narrow and restricted in failing to consider other relevant data. We also reject such an approach.

The *Arcata* trial judge did not accept the plaintiff's method *per se*, but concluded that on the basis of the entire record, 6.6% was a fair rate of interest. In reaching this conclusion, the trial judge consolidated the prime interest rate for the period September 1968 through March 1973 (6.56%) with plaintiff's computed average on its borrowings for the same period (7.36%), achieving an average of 6.86%. The trial judge reconstructed plaintiff's interest computations to account for compensating balances and recognized that plaintiff did receive significant interest payments for 1969 and 1971. Prior to 1969, plaintiff was a prime customer at

various banks and lending institutions and was able to negotiate loans at very favorable rates. After 1969, plaintiff had to pay higher rates. It is clear that the rate used by the trial judge was based in part on the actual cost to plaintiff of borrowing money. The court does not approve of this actual cost method. Plaintiffs are not usually in the business of borrowing money and thus costs based on their own borrowing rates are highly speculative. A plaintiff with a poor credit rating could theoretically receive an award of just compensation at very high interest rates because its actual cost of borrowing money might be very high, while another might be penalized for having a good credit rating. Neither the cost to the Government nor to the plaintiff of borrowing money is an appropriate measure of just compensation, and therefore, we are not bound by the 6.6% rate used in *Arcata*.

The court agrees with the method used by Judge Lane in this case. As the trial judge explained in the findings of fact, long-term corporate bond yields are an indicator of broad trends and relative levels of investment yields or interest rates. They cover the broadest segment of the interest rate spectrum. The corporate bond market is large, substantially in excess of long-term Government bonds and long-term corporate yields measure basic trends and relative levels of interest rates from one period to another.

It is true that the court has computed interest in eminent domain cases at a rate of 4% since 1944. It should be noted that the prime interest rate was below 4% during the years 1944–1956. From 1956 through 1960, the prime rate fluctuated between 3 and 5%. Our awards covering that period allowed a rate, as we think they should have, higher than the prime rates and the rates at which the Government could then have borrowed money. The prime rate increased steadily, from 4.5% in 1960 to 8.5% in 1969. During the period 1971–72, the prime rate ranged from 4⅜% to 6%. Most recently, in 1973–76, the prime rate has varied from 6.75% to 12%. When the prime rate or Moody's Corporate Index increased, the court failed to increase its interest award, not because of any affirmative determination that such an increase was improper or unwarranted, but rather because it was not confronted with a case that presented the necessary evidence properly. *See*,

*Amerace Esna Corporation* v. *United States*, 199 Ct. Cl. 175, 462 F. 2d 1377, 174 USPQ 517 (1972), (no evidence offered to prove requested 6% rate); *Drakes Bay Land Co.* v. *United States*, 198 Ct. Cl. 506, 459 F. 2d 504 (1972), (no proof offered other than stipulated fact that defendant paid 6% interest on district court judgment condemnation cases involving land which became part of the same National Park); *Confederated Salish & Kootenai Tribes* v. *United States*, 193 Ct. Cl. 801, 437 F. 2d 458 (1971), (statistical data offered to court, but not to trial judge); *Carlstrom* v. *United States*, 147 Ct. Cl. 297, 177 F. Supp. 245 (1959), (no special circumstances warranted award higher than 4%).

The parties in this case have briefed the issue and presented sufficient evidence to the trial judge to allow an informed and reasoned determination as to the appropriate measure of just compensation, just as we said they should have done in *Confederated Salish*, if they wanted the time-honored rates to be reconsidered in light of new economic conditions. Accordingly, the court adopts Part V of the trial judge's recommended decision as its own in addition to these added comments.

Plaintiff has not shown any basis for recovery of further delay compensation on account of inflation, and its claim for this is denied.

## VI. *Experimental Use*

The order of the court filed July 12, 1973, *Autogiro Company of America* v. *United States*, 202 Ct. Cl. 1105, permitted the defendant to make "offers of proof" with respect to the manufacture and use of accused helicopters by the defendant "for testing and experimental purposes." At the accounting trial, defendant presented such offers of proof through the testimony of 13 witnesses and 147 documentary exhibits pertaining to about 93 of the 2,237 rotary-wing aircraft involved in this litigation. Defendant has requested 153 detailed findings of fact relative to experimental use, all based on its offers of proof. No findings of fact are or need be made on the testing and experimental use of accused aircraft. It may be noted, however, that at least one of defendant's witnesses testified that the testing of helicopters "was use of those helicopters for the Government."

Defendant contends that under this court's decisions in *Ordnance Eng'r Corp.* v. *United States*, 84 Ct. Cl. 1 (1936), *cert. denied*, 302 U.S. 708 (1937) and 96 Ct. Cl. 278 (1942), and *Chesterfield* v. *United States*, 141 Ct. Cl. 838, 159 F. Supp. 371 (1958), devices of an infringing construction which were used for experimental or test purposes are to be excluded from the computation of compensation under 28 U.S.C. § 1498. That statute provides:

> Whenever an invention described in and covered by a patent of the United States is used or manufactured by or for the United States without license of the owner thereof or lawful right to use or manufacture the same, the owner's remedy shall be by action against the United States in the Court of Claims for the recovery of his reasonable and entire compensation for such use and manufacture.

Defendant's interpretation and attempted expansion of the court's decisions in the two *Ordnance* cases *supra*, pertaining to what those decisions refer to as "ballistic shell" and "experimental shell," are erroneous; and those decisions are inapplicable to the present case. Although in *Ordnance* the court did exclude from the accounting the so-called "experimental shell," there is no discussion in the opinion in either of those cases as to the rationale for their exclusion. The only statement in the *Ordnance* decisions on "experimental" is one sentence: "Experimental shell are shell built for experimental purposes." There is no elucidation as to the determinants of "experimental purposes." Thus, the *Ordnance* lecisions provide no rationale for, or guidance for determining the propriety of, excluding from an accounting so-called "experimental" devices except that they are devices "*built for* experimental purposes." In the present case there is no evidence in defendant's offer of proof that any of the helicopters to which defendant's "experimental use" contentions pertain were built solely for experimental purposes. For that reason alone, the *Ordnance* decisions are inapposite.

Defendant's reliance on the court's opinion in *Chesterfield*, *supra*, is likewise without merit. The court's statement in its opinion there that experimental use does not infringe constituted pure *obiter dictum*. The court's opinion specifically stated:

Per Curiam

> Where the court finds as a fact that the patent claims in suit are clearly invalid * * * it may not be necessary to consider the issue of infringement. 141 Ct. Cl. at 840.

The court's reference to experimental use was clearly unnecessary to the disposition reached in *Chesterfield*. It is also noted that in *Chesterfield* the defendant procured by purchase, not by manufacture by or for the Government, certain alloys which had been developed and used for supercharger buckets and blades. In *Chesterfield*, the claim arose from defendant's *use* of purchased alloys. In the present case, the infringing aircraft were clearly *manufactured* for the defendant.

Plaintiff has excluded from its present claim static test mechanisms manufactured for defendant. Numerous research and development contracts were entered into by the defendant and various manufacturers for the design, development and manufacture of experimental helicopters and none of those specific helicopters are the subject of this litigation.

Defendant urges the court to exclude from compensation any aircraft used by the defendant for testing, evaluational, demonstrational or experimental purposes. Use for such purposes is use by or for the Government and is compensable. Obviously every new helicopter must be tested for lifting ability, for the effect of vibration on installed equipment, flight speed and range, engine efficiency, and numerous other factors. Tests, demonstrations, and experiments of such nature are intended uses of the infringing aircraft manufactured for the defendant and are in keeping with the legitimate business of the using agency. Experimental use is not a defense in the present litigation.

Defendant has also referred to the experimental use portion of Trial Judge Cooper's opinion and report to the court in *Douglas* v. *United States*, 181 USPQ 170 (1974). The court's opinion in that litigation, 206 Ct. Cl. 96, 510 F. 2d 364, 184 USPQ 613 (1975), *cert. denied*, 423 U.S. 825, did not rule on experimental use since the patent claim was held to be invalid. While the trial judge's discussion of the experimental use rule in various courts is not the law of the case in *Douglas*, it is a well reasoned and historical analysis.

In *Douglas*, the testing of the Kestrel aircraft conducted by the Army, Navy and Air Force, to evaluate the aircraft was found by the trial judge to be use of the aircraft which served a valuable governmental purpose.

CONCLUSION OF LAW

Upon the foregoing opinion and on the findings of fact which are made part of the judgment herein, the court concludes that the plaintiff is entitled to recover from the United States in accordance with the opinion. Judgment is entered for plaintiff to that effect. The amount of recovery, including both the basic amount of compensation and the delay compensation, will be determined pursuant to Rule 131(c) under the opinion.

---

NICHOLS, *Judge*, with whom KUNZIG, *Judge*, joins, concurring in the result:

I concur in the decision of the court and in the Per Curiam opinion except for part II, Royalty Compensation. As to that, I concur in the result, because I believe the Royalty Compensation should be at least as much as the conclusions stated in that part will lead to, and, indeed, considerably larger yet. The opinion is correct so far as it rejects the further cuts in Royalty Compensation proposed in Judge Kashiwa's dissent.

The court's decision will slash almost in half the trial judge's proposed decision, which would have awarded $50,926,278, of which $24,570,525 was the principal amount of reasonable and entire compensation, and the remainder was compensation in the nature of interest for delay in payment. The change serves to reward a cynical exploitation of the cost and delay of suing in this court, and its inevitable effect upon a claimant's valuation of his claim.

I would not quarrel with some reduction in the above figures, but I would make it for different reasons and to a lesser extent. It is normal in valuation proceedings to reject the testimony of retained experts on both sides and to award something in between. The trier of fact is not helpless if the testimony is all unacceptably high or low. *The Conqueror*, 166 U.S. 110, 131 (1897); *United States* v. *Northern Paiute*

*Nation*, 183 Ct. Cl. 321, 346, 393 F. 2d 786, 800 (1968). When we have fully in effect the utopia of court-appointed experts under the Federal Rules of Evidence, Rule 706, as adopted in Pub. L. 93–595, this kind of splitting of differences may become less respectable.

Here however, the court has rejected one error only to embrace another. The trial judge unfortunately held that the taking occurred all at once on the occasion of the first infringement by or on behalf of the Government. The court rightly holds that takings occurred from time to time over the years, as helicopters were built. But it wrongly holds that the 1947 royalty agreement with United Aircraft Corporation and the offers by plaintiff to other companies are binding on it, as admissions, and necessitate a royalty reduction to 2% from the trial judge's 3.85%.

After the end of World War II hostilities the wartime .85 rate lapsed though the Royalty Adjustment Act was, as the court admits, at least technically in effect. The Government apparently made no effort to rely on it; rather, it required indemnity agreements from suppliers. This relegated the plaintiff to making the best deal it could with manufacturers amid all the dog eat dog atmosphere of private patent controversy, but without the injunction relief normally available to wronged patentees, because the greater part of the sales were to be to the Government, and the remedy by suit in this court under 28 U.S.C. § 1498 was exclusive. The general expectation was that after many years of costly litigation, some patents would be held valid and some invalid.

The court describes the two agreements with United Aircraft Corp. It professes to derive support for its position from the fact that United's letter, quoted in its fn. 11, was written a year after the 1947 agreement. However, the letter discusses and characterizes that 1947 agreement as purely and simply, on its side, a resultant of assessing the royalty plaintiff demanded against the projected outcome of litigation. No reason appears why the lapse of a year would make that assessment less valid. It is, in my view, a telling letter and vividly portrays the predicament that Autogiro was placed in. Plaintiff's patent counsel testified that plaintiff's assessment of

the situation was the same. This is why plaintiff cut its demands from 5% to 2%. If it had done this because its inventions were not salable, we would have a different case. It knew its inventions were not only salable but indispensable; that manufacturers could not build helicopters "around them," in the patent lawyers' term, *i.e.*, they could not build helicopters without infringement. It also knew that whether manufacturers procured licenses or not, they would build helicopters in the same manner, infringing or not, and would defy any lawsuits that might be brought.

What is any claim worth, in present value, if one knows one must sue in the Court of Claims for 25 years to recover anything upon it? Is it fair to take the fellow who would settle it at the outset for 40¢ on the dollar, and assess his claim at 40¢, though he has not got the *quid pro quo* his sacrifice of 60¢ would have obtained if accepted?

Nobody ever actually paid any royalties at the 2% rate. Plaintiff would have obtained under its 1947 United agreement, if not superseded, and under its offers to others, if accepted, an immediate cash flow. It would also have obtained from anyone who accepted a license, an estoppel to challenge the patents, as the law was before *Lear Inc.* v. *Adkins*, 395 U.S. 653 (1969), which overruled *Automatic Radio Mfg. Co.* v. *Hazeltine Research Co.*, 339 U.S. 827 (1950). Most valuable of all, it would have saved 25 years of litigation. Plaintiff finally sold a paid up license at an even cheaper rate to United, to obtain these blessings. Defendant, and its indemnitors, did not furnish any of the *quid pro quo* that United furnished, and yet now they want the discount that United got. Even the court can see that the under 1% rate is not "reasonable and entire compensation" but somehow the 2% rate is different.

The court's decision not only violates the most elementary notions of reason and justice, but also established law. The general rule in eminent domain is that a landowner's right to recover just compensation may not be measured by the amount another landowner received as a settlement of possible litigation. 4 *Nichols On Eminent Domain*, (3d Ed. Rev. 1975), 12.3113 [2].

Concurring Opinion by Judge Nichols

*Calhoun* v. *United States*, 197 Ct. Cl. 41, 453 F. 2d 1385 (1972), does not require a different result, but by implication indicates we should disregard the post-1946 transactions. In *Calhoun*, plaintiff licensed the patent throughout the industry at a rate of twenty-five cents per unit. The trial judge increased this commercial royalty by one-third since he felt the rate was set by plaintiff with a view to avoiding litigation and since defendant's failure to keep records increased plaintiff's costs in litigation. The court refused to accept the trial judge's figure because:

> * * * There [was] nothing in the evidence to show or to suggest, that the 0.25 cent rate was set beneath fair market value with a view toward avoiding litigation. This license rate was used widely and offered freely to everyone; there were many "takers" at that price. * * * We must assume, in the absence of contrary evidence, that it represented full and fair market value, *i.e.*, the going price. (197 Ct. Cl. at 56–57, 453 F. 2d at 1394).

Considering the casualties that patents suffer by invalidity determinations in the Federal Courts, a bargained license under any patent not yet litigated would possibly show some discount for litigation avoidance, but the teaching of *Calhoun* is that this mere surmise does not *per se* preclude use of a widely accepted commercial rate to establish reasonable and entire compensation. That is all *Calhoun* teaches to me.

The case before us is very different from *Calhoun*. There is conclusive evidence in the record that the parties considered the costs of litigation in negotiating the license agreements. There were not many "takers" of Autogiro's patents after 1946, only United. Further, post-1946 manufacture of helicopters was primarily for the Government, not commercial sales. We can properly infer from the record that the 1947 and 1949 agreements with United were not valid reflections of the patents' fair market value.

I agree with the remainder of the court's decision, as to which, therefore, I need not spell out my views. The amount the trial judge would have awarded is large, perhaps unprecedented. Even this court's meat axed award will be substantial. Large as the involved sums are, here, as always, the precedential effect of our decision is even more important.

Do we really want to tell litigants that we have so little concern about the cost and delay of suing in this court, that we will take as the full value of a claim herein the discounted value which a desperate claimant must accept, if he is to realize anything at all before 25 years of litigation? If that is our position, we have a self-activating mechanism for reducing awards, which the defendant will know how to make the best use of. It is not my idea of justice.

Plaintiff's offers in 1947 do establish that the 5% royalty rate was abandoned. I would consider them to that extent. The situation appears to me to be appropriate for one of those miscalled "jury verdicts" (*cf. A. C. Ball Co.* v. *United States*, 209 Ct. Cl. 223, 531 F. 2d 993 (1976)). I would come up with a $20,000,000 figure for the royalties, to which should be added the compensation for delay in payment.

As a parting shot, I will add I fail to see why this *Jarndyce* v. *Jarndyce* of a case has got to be further prolonged with Rule 131(c) proceedings. Could not the court, by a few minute's work with a pencil, calculate the amount of the award to which its reasoning leads, and convert this claim at long last into a money judgment?

---

SKELTON, *Judge*, concurring in part and dissenting in part:

I concur in all the per curiam opinion, except the award of interest of 6½ percent for the period 1966–1970 and the award of interest of 7½ percent for the period 1971 to date of payment. I think the interest awarded for these years is too high and should be reduced to six percent for the entire period of 1966 to date of payment. This would be in line with 16 U.S.C. § 79c(b)(2) (1970) which provides in pertinent part:

> The United States will pay just compensation to the owner of any real property taken * * * including interest at the rate of 6 per centum per annum from the date of taking the property to the date of payment therefor; * * *

It is true that this statute refers to the taking of real property for the Redwood National Park, nevertheless, it deals with a fifth amendment taking of property by the Govern-

ment and provides the payment of an appropriate rate of interest.

Also, the Declaration of Taking Act, 40 U.S.C. § 258a (1970), 46 Stat. 1421, provides in pertinent part with reference to just compensation for a taking by the United States of any land or easement or right of way in land for public use:

> * * * [A]nd the said judgment shall include, as part of the just compensation awarded, interest at the rate of 6 per centum per annum * * *.

These two statutes establish guidelines for the payment of interest in fifth amendment takings of real property by the United States. While the instant case does not involve real property, it does involve fifth amendment takings by the Government. I think that in the absence of adequate and convincing proof otherwise, we should follow the above statutes and award six percent interest for the above-indicated period.

In the case before us, the majority approves the decision of the trial judge in awarding 6½ and 7½ percent interest for the designated period based on Moody's Composite Index of Yields on Long Term Corporate Bonds. In my opinion, this is not a proper yardstick to measure or determine the amount of interest to be awarded in a fifth amendment taking by the Government. We are not dealing with corporate bonds, which may be speculative as to yield as well as to risk of default, but with an obligation of the United States which usually bears a lower interest rate than that applicable to other borrowers, is not speculative as to yield and bears no risk of default.

The Ninth Circuit Court of Appeals discussed this very point in *United States* v. *Blankinship*, 543 F. 2d 1272 (9th Cir. 1976), in considering the proper way to determine the amount of interest to be paid for a fifth amendment taking by the Government under the Declaration of Taking Act cited above. The court held:

> However, we also hold that the trial court in this case, acting as the trier of fact, did not consider evidence we believe to be of great importance in establishing the proper and reasonable rate. Specifically, the trial court did not have before it certain highly relevant evidence with the result that the rates selected may have been

improperly skewed. The evidence before it was inadequate to establish the rate of interest that would have been available to the person from whom the property has been taken had he, at the date of taking, invested the total amount of any deficiency in the original deposit in a marketable public debt security issued by the United States Treasury having a duration commencing with the date of taking and ending with the deposit in the registry of the court of the entire deficiency with proper interest. Evidence tending to establish such a rate is necessary to fix fairly the just compensation to which the person deprived of his land is entitled. Without evidence of such a rate the rates selected very likely may have been unduly influenced by rates applicable to loans more speculative than one to the United States. * * *

* * * * * *

* * * [W]e are convinced that the proper interest rate applicable to an obligation of the United States may well be lower than that applicable to other borrowers. Moreover, this lower rate is particularly relevant here because the obligation to pay the deficiency is an obligation of the United States, a creditor whose obligation embodies no risk of default. Seizure of land under the Declaration of Taking Act is an act by the United States by which it substitutes for ownership of land, together with the risks attendant thereto, an obligation of the United States which is free of the risk of default. * * *

* * * We believe that the trial court should have focused more on that type of marketable public debt security which constitutes a direct obligation of the United States Treasury having a duration approximating the period during which the deficiency was unpaid. Data of this type appears in the *Treasury Bulletin* [4] and the *Federal Reserve Bulletin.*

[4] Of particular significant is the table setting forth "Yields of Treasury Securities" which appears regularly in the monthly Treasury Bulletin.
E.g., TREAS. BULL., JULY, 1976 at 79.

I agree with the decision of the Ninth Circuit Court in the above case. The method of determining the rate of interest in that case was not the procedure followed by our trial judge. It does not appear that there was any evidence at the trial of the yield of public securities of the United States during the designated period. It is true that the defendant suggested at the trial that the interest rate should be "an amount equal to the average annual yields on a series of hypothetical long term Government bonds which defendant

constructs subjectively." Of course, such a yardstick is speculative and is not the proper way to establish the correct interest rate.

It does not appear that there was any evidence at the trial showing the rate of interest that would have been available to the plaintiff if it had invested, on the dates of taking, the total amounts due it in marketable public debt securities issued by the United States Treasury during the periods involved here. Without such evidence, we are not justified in awarding interest of more than six percent as specified in the two statutes cited above.

The case of *Arcata National Corp.* v. *United States*, No. 771–71, report filed July 25, 1974, wherein the court approved interest of 6.6 percent in a taking case, is not applicable here, because the parties agreed to the 6.6 rate and the court merely approved their agreement. The majority agrees that this is true.

Neither is Pub. L. No. 93–625, § 7, 88 Stat. 2108 of January 3, 1975, providing for payment by the Government of interest of nine percent per annum on overpayments of internal revenue taxes, cited by the majority, controlling in this case. There is not the slightest evidence or indication that Congress intended the Act to apply in any way to eminent domain cases. Besides, there is a big difference between interest on an overpayment of taxes and interest in a taking case. An overpayment of taxes allows the Government to use the taxpayer's money until a refund is made and the nine percent interest is payment by the Government for such use. Whereas, in a taking case, interest is not paid for use of money belonging to the party whose property is taken, but is awarded to him as a part of his damages in the form of delayed compensation.

---

KASHIWA, *Judge*, concurring in part and dissenting in part:

I concur with the views expressed in the majority opinion regarding: I. Similarity, III. Contribution, IV. Spare Parts, V. Delay Compensation and VI. Experimental Use. But with relation to the portion of the opinion entitled II. Royalty

Compensation, I concur in part and dissent in part as hereinafter shown.

The majority found, relative to II. Royalty Compensation, that:

> * * * Effective as of January 1, 1947, Autogiro entered into an agreement with United Aircraft Corporation for a royalty of $500 an aircraft for 1946–1948, with the $500 ceiling to change to 2% of the airframe price on and after January 1, 1949. After this United agreement was executed, the plaintiff proposed similar licenses to other major manufacturers of helicopters, in effect announcing its post-war rate to be 2%. * * * [Footnote omitted.] [At page 183.]

It is on these offers by plaintiff, made in 1947-1948, to other manufacturers of aircraft, mainly Piasecki, McDonnell and Bell, of licenses similar to that of United Aircraft Corporation's (United) license agreement effective January 1, 1947, that the majority decided on the post-war rate of 2%. A careful reading of the majority opinion shows that the opinion is not clear as to whether it meant that the 2% rate was only a maximum rate or whether the 2% rate was a flat rate with no downward, lower rate permitted. As to these offers, the majority states:

> All this means that the post-1946 United agreement at 2% as well as the post-1946 offers made by Autogiro at that same level—plaintiff's own position deliberately taken in 1947 and 1948—have a *prima facie title to acceptance as the reasonable royalty for 1946–1964.* * * * [Emphasis supplied.] [At page 186.]

The phrase "*prima facie* title to acceptance" is ambiguous. The ambiguity is made more apparent when one reads the majority's footnote 16. It reads as follows:

> [16] For the period before 1949, the 1947 United agreement provided that the royalty on any one aircraft should not exceed $500, and also that from 1947 onward the minimum royalty per year should be $10,000. *We consider these provisions of that agreement to be applicable to this case,* though the only one that is likely to be operative is the $500 ceiling for aircraft used by or manufactured for the defendant prior to January 1, 1949. After January 1, 1949, the 2% rate applies. [Emphasis supplied.] [At page 187.]

The record in this case shows that United's $500 ceiling per aircraft at that time amounted to a .66% rate.[1] A rate of .66% is only one-third of the 2% rate. Since the majority allows this lower rate of .66% for the 1947–1948 period, a careful reader of the opinion may conclude that the phrase "*prima facie* title of acceptance" is interpreted to mean that the 2% rate is only a maximum rate and so lower rates are permitted. But in the same paragraph to which footnote 16 aforequoted belongs, the majority again makes a broad, strong statement:

> * * * The question remains whether the royalty should be set at a still lower figure, as defendant requests. This is not a simple skein to unravel, *but our conclusion is that the 2% rate should be accepted for all infringements.* The main reason is that, quite unlike the 2% figure, there is no indication from Autogiro that any lesser royalty was ever satisfactory, acceptable, or offered generally. [Emphasis supplied.] [At page 186.]

So one can only conclude that there is an inconsistency at this very important point of the majority opinion. This inconsistency caused the majority a problem in setting its post-1949 rate. The 1949 fully paid-up license to United was less than 2%. The majority answered defendant's argument for a lower than 2% rate for the post-1949 rate as follows:

> * * * The patentee's situation was unusual in that the Government was the dominant consumer of the articles embodying the patents, and this put the plaintiff to a disadvantage since it was very unlikely that an injunction could be obtained against United (or other in-

[1] The 1947 United license agreement provided as follows:

"In respect of royalties accrued under the foregoing provisions of this Section within the three calendar years ending December 31, 1948, *the royalty on any one aircraft shall not exceed Five Hundred Dollars ($500.).* As to any such aircraft, if the royalty so paid by Licensee equals $500., there need be no determination (for the purposes of this Section) as to which Patents of Autogiro are employed therein. For the calendar year 1946, the royalty as calculated under the foregoing provisions of this Section, on any aircraft made by Licensee and sold and delivered to and accepted by the Government in 1946 shall in no event exceed the royalty which would have been payable thereon had such aircraft been made, sold, delivered and accepted under the License Agreement between the parties dated as of the 24th day of March 1944." * * * [Emphasis supplied.] [At 10, section 5.]

By reason of the last sentence, some aircraft license payments only amounted to $445.82 per aircraft (1946 for Navy aircraft). But the $500 figure was the predominant measure used. The 2% rate provided in an earlier paragraph of the agreement was not used at all.

The .66% rate is computed by using a fraction, $500 over $75,212. The average cost per helicopter in 1948 was $75,212. It is interesting to note that the wartime rate was .85%.

> fringers). We therefore discount, in the absence of any expression of contentment, Autogiro's granting to United, at the latter's strong insistence, of a paid-up license in 1949. No offers to other companies, stemming from this paid-up license, were made by plaintiff. The theoretical constructions of defendant's expert—who reached a figure which was only a fraction of 2%—were based in largest part on the paid-up license; *the expert did not consider plaintiff's hobbled position in trying to determine what the "parties might well have agreed upon"* (*Saulnier* v. *United States*, *supra*, 161 Ct. Cl. at 227 (1963)) *if Autogiro had been relatively free of this one-sided litigation pressure.* * * * [Emphasis supplied. Footnotes omitted.] [At pp. 186–87.]

Since the majority first refers to dominant Government consumption, injunctions and one-sided litigation pressure, the majority was referring to Governmental actions under 35 U.S.C. §§ 89–96, popularly known as the Royalty Adjustment Act of 1942.[2] It is interesting to note that in 1948 this

---

[2] 35 U.S.C. § 89 reads as follows:

"§ 89. *Adjustment of royalty rates; notice, remedies against licensee*

"To aid in the successful prosecution of the War, whenever an invention, whether patented or unpatented, shall be manufactured, used, sold, or otherwise disposed of for the United States, with license from the owner thereof or anyone having the right to grant licenses thereunder, and such license includes provisions for the payment of royalties the rates or amounts of which are believed to be unreasonable or excessive by the head of the department or agency of the Government which has ordered such manufacture, use, sale, or other disposition, the head of the department or agency of the Government concerned shall give written notice of such fact to the licensor and to the licensee. Within a reasonable time after the effective date of said notice, in no event less than ten days, the head of the department or agency of the Government concerned, shall by order fix and specify such rates or amounts of royalties, if any, as he shall determine are fair and just, taking into account the conditions of wartime production, and shall authorize the payment thereof by the licensee to the licensor on account of such manufacture, use, sale, or other disposition: *Provided, however,* That the licensee or licensor, if he so requests within ten days from and after the effective date of said notice, may within thirty days from the date of such request present in writing or in person any facts or circumstances which may, in his opinion, have a bearing upon the rates or amounts of royalties, if any, to be determined, fixed and specified as aforesaid, and any order fixing and specifying the rates and amounts of royalties shall be issued within a reasonable time after such presentation. Such licensee shall not after the effective date of said notice pay to the licensor, nor charge directly or indirectly to the United States a royalty, if any, in excess of that specified in said order on account of such manufacture, use, sale, or other disposition. The licensor shall not have any remedy by way of suit, set-off, or other legal action against the licensee for the payment of any additional royalty remaining unpaid, or damages for breach of contract or otherwise, but such licensor's sole and exclusive remedy, except as to the recovery of royalties fixed in said order, shall be as provided in section 90 of

(Continued)

court decided that said sections 89–96 do not apply where there is "no license agreement with anyone for the payment of a royalty * * *." *Fulmer* v. *United States*, 111 Ct. Cl. 591, 593, 77 F. Supp. 927, 928 (1948). We have quoted section 89 fully in the margin to show that the mechanics of the Act call for royalties to be paid periodically. Where the royalty is paid in a lump sum, there is no royalty payment which the agency head may act upon to permit section 89 to operate. United's 1947 license expired as of the end of 1948 and since its post-1949 license was a fully paid-up license upon execution, no royalties were payable under any agreement. This court in *Fulmer* v. *United States*, *supra*, held:

> Plaintiff has no cause of action under the terms of Royalty Adjustment Act of October 31, 1942 (35 U.S.C.A. 89–96), *Ivor B. Yassin* v. *United States*, 110 Ct. Cl. 211. *Plaintiff had no license agreement with anyone for the payment of a royalty for the use of his alleged invention in connection with the manufacture of articles for the United States, and there could not, therefore, be an order by the head of a department or agency upon*

(Continued)
this title. Written notice as provided herein shall be mailed to the last known address of the licensor and licensee and shall be effective upon receipt or five days after the mailing thereof, whichever date is the earlier. Oct. 31, 1942, c. 634, § 1, 56 Stat. 1013."

Section 90 mentioned above provides for suit by any licensor aggrieved by an order issued under section 89 in this court.

The majority in footnote 13 states:

"We refer to the fact that a patentee cannot obtain an injunction against a government-supplier or government-contractor and is confined, for his exclusive remedy, to a suit for 'reasonable and entire compensation' (*i.e.* monetary compensation) against the United States under 28 U.S.C. § 1498. These suits generally take a long time to come to their conclusion and the patentee, even if he prevails, normally obtains no compensation until the litigation is at an end. (The reference is not to the Royalty Adjustment Act, *see* note 12, *supra*.)"

The majority's emphasis is that "a patentee cannot obtain an *injunction against a government-supplier or government contractor and is confined* * * * *to a suit* * * * under 28 U.S.C. § 1498." The facts are undisputed that during pre-1949 and post-1949 periods substantial non-governmental commercial sales were made by United. Commercial sales are clearly not covered by 28 U.S.C. § 1498. *Systron-Donner Corp.* v. *Palomar Scientific Corp.*, 289 F. Supp. 148 (1965). *Systron-Donner* was very similar to the present case in that both governmental and commercial sales were involved. The court held that 28 U.S.C. § 1498 had no application in a suit in a federal district court for patent infringement seeking the usual injunctive relief based on commercial sales only. So under the facts of this case, 28 U.S.C. § 1498 did not actually have the restrictions preventing an injunctive suit as the majority feared. If the plaintiff was interested in an early decision regarding validity of plaintiff's patents by way of an injunctive suit, plaintiff could have immediately started an injunctive suit for patent infringement in a federal district court based on these commercial sales.

> *which that act conditions the right to sue.* An allegation that defendant used plaintiff's unpatented device is not, therefore, sufficient to bring plaintiff's case within the terms of that Act. [Emphasis supplied.] [111 Ct. Cl. at 593, 77 F. Supp. at 928.]

See, also, *Yassin* v. *United States*, 110 Ct. Cl. 211, 228, 76 F. Supp. 509, 519 (1948). The exact date of the *Fulmer* decision was June 1, 1948, and *Yassin* was decided March 1, 1948. It is clear that plaintiff in 1949 drafted its fully paid-up license to United under the *Fulmer* holding of this court to free itself of any possible litigation under said 35 U.S.C. §§89–96. So plaintiff was not under the "one-sided litigation pressure" referred to by the majority. The 1949 paid-up license from plaintiff to United provided as total consideration the sum of $325,000. Even if plaintiff had raised the amount from $325,000 to $5 million and United agreed to such raise, since it was a paid-up license it was not subject to the Royalty Adjustment Act. I shall hereafter again refer to the 1949 fully paid-up license under the damage computation aspects of this dissent.

So if the majority meant that the 2% rate was a flat rate "for all infringements" and that for the post-1949 years it was a flat 2% rate with no lower rate permitted, I disagree. I agree with the defendant that the 1947–1948 offers only set a "*maximum ceiling of 2%*" and that a lower percentage rate figure was permissible. I take this position not only on my foregoing *Fulmer* rebuttal but on grounds more fundamental and basic which I shall next discuss.

The United license by plaintiff contained in addition to the 2% rate clause and others the following most-favored licensee clause:

> Section 11. If, under similar circumstances and otherwise on substantially the same terms and conditions as this Agreement, a license shall hereafter be granted by Autogiro for the manufacture of man-carrying aircraft with sustaining rotors under all or substantially all the Patents of Autogiro at a royalty rate or rates lower than the corresponding rate or rates hereinabove provided, Autogiro will promptly notify Licensee of the grant of such license and *Licensee shall be entitled to the benefit*

*of such lower rate or rates for its operations hereunder subsequent to such grant,* * * *. [Referred to as the *most-favored licensee clause.*] [Emphasis supplied.]

The record shows that the only three other substantial manufacturers in the United States then in the field competing with United were Piasecki, McDonnell and Bell. The package license written outlines and/or drafts containing the 2% rate offer separately sent in 1947 and 1948 to Piasecki, McDonnell and Bell contained the identical above-mentioned most-favored licensee clause. The early Kellett license also contained the same clause. The 1943 and 1944 Firestone licenses extensively discussed in the trial judge's opinion in this case contained the same most-favored licensee clause. It is axiomatic that competitors must be dealt with fairly and equally and in all of its licenses and proposals plaintiff recognized this basic principle by using and making it known that it offered in its future licenses the most-favored licensee clause. Plaintiff well knew that Piasecki, McDonnell and Bell were competing with United in the helicopter market and that Piasecki, McDonnell and Bell would not agree to a license without the protection of the most-favored licensee clause. Plain elementary economics of marketing and the very evidence in this case prohibit any other assumption.

Defendant has taken a license by eminent domain in any applicable patent or patents from plaintiff by reason of the unauthorized making or use of the patented invention(s) in each aircraft at the time of Governmental acceptance or use of that aircraft. *Calhoun* v. *United States*, 197 Ct. Cl. 41, 453 F. 2d 1385 (1972); *Regent Jack Mfg. Co.* v. *United States*, 167 Ct. Cl. 815, 337 F. 2d 649 (1964). This license, under 28 U.S.C. § 1498, should be the equivalent of what the parties "might well have agreed upon," *Saulnier* v. *United States*, 161 Ct. Cl. 223, 227, 314 F. 2d 950, 952 (1963), or "[w]hat would the parties have taken and paid if the matter had come to an express agreement?" *Olsson* v. *United States*, 87 Ct. Cl. 642, 659, 25 F. Supp. 495, 499 (1938), quoting from *Wood* v. *United States*, 36 Ct. Cl. 418, 426 (1901). In order to make such a determination, the court should "place [itself] in the position occupied by the contracting parties * * *."

*Berdan Fire-Arms Mfg. Co.* v. *United States*, 26 Ct. Cl. 48, 80 (1890) (implied contract case cited with approval in *Olsson*, 87 Ct. Cl. at 659–660, 25 F. Supp. at 499). In the past when the court has done this, it has considered as one of the most important factors or "bargaining points" the general licensing practice in the particular industry and, more precisely, the patent holder's other arrangements with parties in a similar bargaining position as the litigants. *Richmond Screw Anchor Co.* v. *United States*, 67 Ct. Cl. 63, 72 (1929); *Breese Burners, Inc.* v. *United States*, 140 Ct. Cl. 9, 17–18 (1957). In the case before us plaintiff, by its own documents accompanying the 1947–1948 offers, included the most-favored licensee clause. Defendant relies not only on custom or practice in the industry but on the documents in evidence showing that plaintiff offered each competing manufacturer the most-favored licensee clause. A stronger case could not have been shown by defendant.

The majority held with relation to the 2% offer that it was the market rate because "the significant fact is that plaintiff made the offer and made it widely." The most-favored licensee clause accompanied each of the 2% rate offers so if the offers of the 2% rate were "offered generally," the accompanying most-favored licensee clause was also "offered generally," sufficient to tie the two together. They together established a lower rate than the 2% rate if plaintiff offered a preferred rate to one of the manufacturers. The result was that although the 2% rate offer was made, plaintiff also offered a lesser rate to all substantial manufacturers where the facts showed that any one of the manufacturers was offered a preferred rate by plaintiff. The majority felt and stated that the lower than 2% rate problem is "not a simple skein to unravel" because it did not take the most-favored licensee clause into consideration. I believe that if the majority had considered the most-favored licensee clause and had made it a part of the 2% offer, the unraveling would have been easy and without difficulty.

The evidence is undisputed that United was offered preferred rates by plaintiff. Autogiro in 1947–1948 allowed United a preferred $500 per aircraft advantage. We have heretofore discussed this 1947–1948 preference so I will not dwell on it again except to state that even without consider-

ing and taking into account the most-favored licensee clause, the majority felt that the $500 advantage (.66% rate) given by plaintiff to United must also be given defendant on the total damage question posed by this phase of the litigation. The majority must have felt the unfairness resulting from a refusal to allow the .66% rate because it was plaintiff which granted this lower .66% rate and plaintiff must suffer the consequences of its offering such a low rate.

Plaintiff also entered into a written agreement in 1949 with United for a lesser rate than the 2% rate. The majority found:

> * * * In 1949, after some months of negotiation triggered by United's disinclination to let the 2% rate go into effect, plaintiff granted United a paid-up license at considerably less than 2% per aircraft. * * * [At page 183.]

*The paid-up license transaction in 1949 was initiated in 1948 with an offer by plaintiff to United to sell its entire patent holdings for $750,000.* This is an established fact in this case. I do not take this self-valuation by plaintiff of the total worth of its patents lightly just because it was only an offer. The offer finally ended by plaintiff granting a paid-up license in 1949 to United for $325,000. I consider the $750,000 offer highly prejudicial to plaintiff because of its connection to the $325,000 transaction. A detailed analysis of the evidence relating to the transaction which started with the $750,000 proposal by plaintiff shows that in a July, 1948, letter, United had expressed its firm conviction that a total of $325,000 in royalties was the most that United and its licensee Nash, considered as a single licensee, should be expected to pay for a paid-up license under plaintiff's patents and that plaintiff should look to other licensees or its own manufacture for any additional value ascribed to the patents. United and its licensee Nash paid total royalties of $136,477.98 for helicopter sales to the defendant under the wartime 1943 and 1944 package licenses. United also paid royalties for aircraft delivered by the end of 1948 under its 1947 package agreement of $67,783.28, of which $46,283.28 were royalties on sales to the Government. Accordingly, plaintiff effectively accepted United's position in principle, for United paid the balance of

the total sum of $325,000, or $120,738.74, in January, 1949, rather than spread it out over the three years 1949 to 1951, for a fully paid-up package license under all of plaintiff's 224 utility (including all 11 in suit) and three design patents then issued and under 52 pending applications. The arithmetic is exact and is as follows:

| | |
|---|---|
| $136,477.98 | Paid under 1943 and 1944 licenses. |
| +67,783.28 | Paid under 1947 license. |
| $204,261.26 | |
| $325,000.00 | Total price. |
| −204,261.26 | See above addition. |
| $120,738.74 | Difference. |

We quote the above arithmetic to show that the sale price of $325,000 was not a figure picked out of the clear sky. The $204,261.26 was based on past royalties paid under prior licenses of United. This prevents any argument by plaintiff of guessing on the part of defendant because the arithmetic is exact. The paid-up license cost United $120,738.74. These breakdowns of figures are from plaintiff's own documents produced for the record in this case. It is important to observe the above arithmetic because, as it is hereafter shown, the defendant's expert found this analysis to be material in his opinion testimony in support of his views as to what the damages to plaintiff should be.

The majority, after unanimously rejecting the trial judge's single-taking theory, has in effect agreed with defendant that the 2% rate in the 1947 license to United and in plaintiff's offers to others in 1947–1948 is where this court should start. The majority in effect held that the material time frame was 1947–1948, when the offers were made. I agree with the majority.

The question now is what is the percentage below the 2% rate? When plaintiff's offers to all manufacturers are considered in the above time reference, one important factor, fundamental in market evaluation, looms above all the others. After United, the leader in the helicopter industry, had received its 1949 paid-up license, no other manufacturer could pay substantially more and expect to compete in either

the Government or commercial market place. Those postwar arrangements, when properly compared and analyzed in light of the most-favored licensee clause, must operate under said clause to place a ceiling lower than the 2% rate on plaintiff's recovery. To view the case otherwise is simply to ignore the market value which plaintiff itself placed on a license under its patents.

When considering the merits of a proposed compensation scheme, it is often the practice to compare the recovery under that scheme to extrapolations from other agreements or transactions. Such comparisons give the court a guide to the comparative fairness of the scheme. *Saulnier* v. *United States*, 161 Ct. Cl. at 226–227, 314 F. 2d at 951–952.

In the period from 1947 to 1948, on an aircraft which cost basically $75,000, United was paying a running royalty of $500 per aircraft. Clearly, United felt that continuation of such a running royalty beyond 1949 was excessive. However, even if a similar running royalty was applied to the aircraft in this accounting, plaintiff's recovery would be far below the $24 million awarded by the trial judge or even the $12.8 million plaintiff would receive under its self-imposed 2% ceiling.

The average cost of the over 2,200 aircraft in this accounting is $287,273. Applying to each of these aircraft a running royalty of basically the same level as under the 1947 United agreement, *i.e.*, ($287,273 ÷ $75,000) × $500 = $1,915, the plaintiff would receive a basic royalty compensation of $4,264,705. Clearly, this is more than United was willing to pay and, thus, is more than its competitors could reasonably afford to pay. However, this figure does demonstrate the unreasonableness of the $12.8 million figure under the flat 2% rate ceiling.

Relative to the use of expert testimony, Congress, under sections dealing with patent litigation in 35 U.S.C. § 284 (1952), specifically provided as follows:

> The court may receive expert testimony as an aid to the determination of damages or of what royalty would be reasonable under the circumstances.

And it is not only by statute but the Court as shown in *Sinclair Refining Co.* v. *Jenkins Petroleum Process Co.*, 289 U.S.

689 (1933), has encouraged reliance on expert testimony. In patent litigation with relation to the use of expert testimony to aid the Court in assessment of damages, the Court in *Sinclair Refining Co.*, supra at 697-698, stated that even in cases where there are no actual sales, expert testimony may be allowed:

> * * * A patent is a thing unique. There can be no contemporaneous sales to express the market value of an invention that derives from its novelty its patentable quality. Cf. *United States* v. *Swift & Co.*, 270 U.S. 124; *Todd* v. *Gamble*, 148 N.Y. 382; 42 N.E. 982. But the absence of market value does not mean that the offender shall go quit of liability altogether. The law will make the best appraisal that it can, summoning to its service whatever aids it can command. *United States* v. *Swift & Co.*, *supra; U.S. Frumentum Co.* v. *Lauhoff*, 216 Fed. 610; *Industrial & General Trust, Ltd.* v. *Tod*, 180 N.Y. 215, 232; 73 N.E. 7; Sedgwick, Damages, 9th ed., vol. 1, pp. 491, 504. At times the only evidence available may be that supplied by testimony of experts as to the state of the art, the character of the improvement, and the probable increase of efficiency or saving of expense. *Dowagiac Mfg. Co.* v. *Minnesota Moline Plow Co.*, 235 U.S. 641, 648, 649; *Suffolk Co.* v. *Hayden*, 3 Wall. 315, 320; *U.S. Frumentum Co.* v. *Lauhoff*, *supra.* * * *

Fortunately, in this case there was an admitted, fully paid-up sale of patent rights by plaintiff to United. The use of the expert by defendant herein was not to establish the sale. His testimony was an analysis of the admitted sale by plaintiff. This is a much stronger case for expert testimony than in *Sinclair Refining Co.* and the evidence in this case is on much firmer ground than what this court had to rely on in *Saulnier* v. *United States*, *supra.* In ascertaining damages resulting from defendant's use of aircraft canopy assembly patents owned by plaintiff, this court said in *Saulnier:*

> Of course, the best guide for the determination of just compensation are the royalties agreed upon between the patentee and licensees in arm-length transactions. Unfortunately, there are no commercial licensees in this case, but the settlement between plaintiff and the British Government does establish a guide. This was negotiated after the war was over. Great Britain was a government foreign to plaintiff, who was a Frenchman. Negotiations lasted over a period of 18 months. A price was agreed

upon of $14 per plane for from 26,000 to 27,000 planes, a total consideration of 99,090 British pounds. At the then rate of exchange, this amounts to $376,542. [161 Ct. Cl. at 226, 314 F. 2d at 952.]

In other words, the use of expert witnesses is encouraged in this field and much discretion is allowed the courts in the use of these experts. In this case we had the benefit of a true expert witness, Mr. Glassman (defendant's chief witness), and the 1949 fully paid-up license.

With relation to expert testimony introduced by the parties in this case, it appears that the plaintiff submitted expert testimony to prove its claim for damages under its single-taking theory. The evidence plaintiff produced was relevant under the Firestone Tire and Rubber Company license. The facts and theory involved in plaintiff's approach did not fit into or answer defendant's entirely separate and different approach. Defendant brought forward Mr. Glassman as its expert witness to offer expert testimony in support of its computation of plaintiff's damages based on facts surrounding the United licenses of 1947 and 1949. It happens that as the case now turns out, we have uniformly rejected plaintiff's single-taking approach and plaintiff is without evidence to rebut Mr. Glassman's opinion evidence. Plaintiff in its brief before this court, answering Mr. Glassman's expert testimony, does not point to any expert testimony produced by plaintiff to refute Mr. Glassman's expert testimony. Mr. Glassman's opinion testimony remains uncontroverted. It cannot be refuted because it is plain arithmetic based on figures in the record.

Mr. Glassman has the following qualifications. He possesses both a law degree and an engineering degree. He worked in the Patent Office for about four years, mostly as a Patent Examiner, and thereafter was employed by the Department of the Army in the Office of the Chief Signal Officer and later, after an Army reorganization, in the Army Materiel Command, performing patent work for the Army from 1945 for about 27 or so years. During the time when he was working in the Office of the Chief Signal Officer and, for part of the time, in the Army Materiel Command in connection with investigation of infringement claims and offers of licenses, he

personally negotiated on behalf of the Government some 15 to 20 license agreements or settlements of infringement claims. He also reviewed about 1,000 proposed license agreements between United States companies and foreign companies pertaining to the export of data relating to munitions of war under State Department Export Control Regulations, which often involved the transfer of patent or data rights. Mr. Glassman also had responsibility for determining or investigating the propriety of royalty charges to Army contracts involving companies, including those in the aircraft industry such as Lockheed, Boeing-Vertol, and Hughes. He has previously given testimony in four other patent accounting cases to determine reasonable royalty rates in the Court of Claims. I am impressed by his qualifications. These qualifications are substantial when compared to the qualifications of plaintiff's witnesses. Plaintiff's chief expert witness, H. F. Gregory, testified regarding damages on a patent-to-patent basis. It is clearly not relevant under the present status of the case. It is interesting to note that he didn't know what a "file wrapper" was. He had no prior experience in patent procurement.

Mr. Glassman used the methodology and calculations shown in the margin.[3] Clearly, Mr. Glassman's analysis was soundly based. Plaintiff is certainly due no compensation more than 0.1299% of the trial judge's prices for the 2,227 aircraft involved in this accounting of $639,243,969, or the sum of $830,377.92, paid up as of January 1, 1949.[4] I am of the view that there should be entry of judgment in favor of plaintiff and against defendant of $830,500 together with

[3] Mr. Glassman stated that royalty compensation in this case rests on:

(1) extrapolations from the 1947 and 1949 license agreements with United and royalty payments made thereunder,

(2) United's sales of helicopters actually delivered in the period from the first unauthorized use for which compensation is sought in this case (December 27, 1946) to December 31, 1948, and

(3) projected sales which plaintiff might reasonably anticipate for United from January 1, 1949, to the end of the accounting period in this case (May 27, 1964).

The 1947 license is the running royalty type, while the 1949 license is the paid-up type. Consequently, certain assumptions have to be attributed to plaintiff in negotiating the 1949 agreement in order to make extrapolations from both agreements. Mr. Glassman's approach was to take the facts known to the plaintiff in late 1948 and early 1949, including the two United agree-

(Continued)

$1,326,723.75 as interest, computed as of January 1, 1949 to the end of 1976, under the rates mentioned in IV. Delay Compensation of the majority opinion. The total judgment in my view in favor of plaintiff and against defendant should be $2,157,223.75. There is no necessity of delaying this case any further.

---

(Continued)
ments, and what the plaintiff might reasonably anticipate for helicopter orders for United after 1948 and arrive at a royalty rate that would be applicable to the accused helicopters purchased by the defendant in the period December 27, 1946, to May 27, 1964. So what are the facts that were known by the plaintiff during this period?

A. *The Facts*

1. In mid-October, 1948, the plaintiff's president knew that:

(a) United had received during fiscal year 1948 orders from the defendant for 85 helicopters at a total price of $6,393,000, an average of $75,212 per helicopter.

(b) United had received from July 1, 1948, to October 13, 1948, a period of .285 years, orders from the defendant for 37 helicopters for an unknown price.

(c) Accordingly, the plaintiff knew that 122 helicopters had been ordered by the defendant in the two periods (1.285 years).

2. The plaintiff's president knew in January, 1949, that during calendar year 1947, United had sold 22 helicopters to the commercial market for approximately $1,510,000 and during calendar year 1948 had sold 16 helicopters to that market for approximately $1,120,000, an average of 19 helicopters per year.

3. The plaintiff's president also knew in January, 1949, that:

(a) For the calendar years 1947 and 1948, United had paid the plaintiff a total of $63,500 in royalties under the January 1, 1947, license on 127 helicopters *delivered* during that period. No royalties were paid for the period December 27–31, 1946.

(b) United had stated in a letter dated July 27, 1948, to plaintiff that modifications would have to be made in the January 1, 1947, license if it were to continue.

(c) On January 7, 1949, United and the plaintiff entered into a paid-up license, effective January 1, 1949, covering commercial and military helicopters for the sum of $120,738.74.

B. *Assumptions of Witness*

1. Since the known average cost per helicopter of 85 defendant helicopters referred to in A.1.(a) above was $75,212, he assumed that the cost figure would remain constant throughout the accounting period and that the number of helicopters procured by the defendant each year from United would remain constant (122 helicopters per 1.285 years, or approximately 95 helicopters per year). (In calculating an effective royalty rate, the assumption that the cost per helicopter remained constant works to the advantage of the plaintiff where the cost per helicopter *actually rose* in future years. This is due to the fact that the higher the projected procurement in C.3 below, the larger the denominator in C.7 and, accordingly, the smaller the royalty rate.) Over the entire accounting period of almost 17.5 years, the defendant actually procured 2,227 helicopters from contractors other than United, an average of 127 per year.

2. Since United sold 22 helicopters to the commercial market in 1947 and 16 in 1948, for an average of 19 per year, he assumed that United would sell 19 helicopters per year to the commercial market during the remainder of the

(Continued)

BENNETT, *Judge*, concurring in part and dissenting in part:

Though I join in most of the court's opinion, I cannot accept the majority's reasoning in part II (Royalty Compensation) in support of the 2-percent royalty rate. Rather, I basically agree with Judge Kashiwa's approach to that issue,

---

(Continued)
accounting period (January 1, 1949–May 27, 1964) and that the unit price would remain the same as the unit price to the defendant, i.e., $75,212.

C. *The Calculations of Witness*

1. The periods referred to in A.1. (a) and (b) above, during which the defendant ordered 122 (85+37) helicopters from United, total 1.285 years.

2. The accounting period in this case is 17.5 years and extends from December 27, 1946, to May 27, 1964. This period includes 15.403 years that fall within the January 1, 1949, paid-up license with United.

3. Projected Sales by United to Defendant and Commercial Markets—January 1, 1949–May 27, 1964.

(a) *Defendant*

(1) (average number per year from A.1.(c)) × (number of years) = (total number of helicopters from January 1, 1949, to May 27, 1964); (122 ÷ 1.285) × 15.403 = 1,462.

(2) (total number in period) × (assumed price per helicopter) = (dollar sales); 1,462 × $75,212 = $109,960,000 (rounded off to the nearest $10,000).

(b) *Commercial*

(1) (average number per year from A.2) × (number of years) = (total number of helicopters from January 1, 1949, to May 27, 1964); 19 × 15.403 = 293.

(2) (total number in period) × (assumed price per helicopter) = (dollar sales); 293 × $75,212 = $22,040,000 (rounded off to nearest $10,000).

(c) Total, (a)+(b) = $132,000,000

4. Actual Sales by United in the Period December 27, 1946, to December 31, 1948

(a) *Defendant*

(1946—December 27–31 only) 0+(1947) $1,884,677+(1948) $5,287,175 = $7,171,852.

(b) *Commercial*

(1946—December 27–31 only) 0+(1947) $1,510,000+(1948) $1,120,000 = $2,630,000.

5. Total United Sales (actual and projected)—December 27, 1946, to May 27, 1964

| | |
|---|---|
| From 3(c) | $132, 000, 000 |
| From 4(a) | 7, 171, 852 |
| From 4(b) | 2, 630, 000 |
| | $141, 801, 852 |

6. Total Royalties Paid by United to Plaintiff

| | |
|---|---|
| 1946 (December 27–31, 1946) | 0. 00 |
| 1947 and 1948 | $63, 500. 00 |
| January 1, 1949, to May 27, 1964 | 120, 738. 74 |
| | $184, 238. 74 |

7. Royalty Rate

$$\frac{\text{(Total Royalties)}}{\text{(Total Sales)}} \times 100\% = \text{(Effective Royalty Rate)}$$

$$\frac{184{,}238.74}{141{,}801{,}852} = .1299\%$$

and concur in his result. Like Judge Kashiwa, I find an unexplained, telling inconsistency between the majority's approval of the 2-percent rate for license compensation from 1946 onward, and its recognition that a $500-per-aircraft figure governed plaintiff's license agreement with United in 1947 and 1948. Even more undermining of the 2-percent rate is the fact that it was never actually used to measure a fair return to plaintiff on its patents; that rate was neither accepted by any other potential licensees nor allowed to go into effect under the 1947 United license agreement. The 2-percent figure may well have been satisfactory to plaintiff, but then so was the $500-per-craft rate, and so further, as Judge Kashiwa demonstrates, was the return received under the 1949 paid-up license. Accordingly, there is no warrant for the majority's conclusion that a 2-percent compensation level should apply on the theory that no "lesser royalty was ever satisfactory, acceptable, or offered generally." Following Judge Kashiwa, I think that the 1949 paid-up license agreement was not so clearly the product of "one-sided litigation pressure," the assumption used by the majority to brush aside evidence that could lead to a more than tenfold reduction in plaintiff's recovery. That agreement should be taken into account, in keeping with the economic reality embodied in the "most favored licensee" clause of the typical royalty agreement that plaintiff offered to potential licensees. As Judge Kashiwa explains, "[a]fter United, the leader in the helicopter industry, had received its 1949 paid-up license, no other manufacturer could pay substantially more and expect to compete in either the Government or commercial market place." Defendant is unquestionably entitled, as a matter of law as well as by analogy to the "most favored licensee" provision, to enjoy a royalty rate no less favorable than any of plaintiff's licensees. The impact of the paid-up license was carefully and properly considered in the unrebutted testimony of defendant's expert witness Glassman, reaching a just compensation rate far less than 2 percent and more in line with that stated in Judge Kashiwa's opinion.

[4] This figure is obtained by multiplying $639,243,969 by .1299%, which is $830,377.92. I recommend an even number of $830,500. The $639,243,969 was the trial judge's total for the 2,227 aircraft involved in this accounting.

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR REHEARING

[March 4, 1977]

ORDER

*J. Edward Shinn*, attorney of record for plaintiff.

*B. Frederick Buchan, Jr.* and *Thomas J. Scott*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before DAVIS, *Judge*, Presiding, COWEN, *Senior Judge*, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges*, *en banc*.

---

This case comes before the court on defendant's motion for rehearing and plaintiff's response; plaintiff's motion for rehearing, etc. and defendant's reply; plaintiff's motion for leave to file a response, and plaintiff's response to defendant's reply to plaintiff's motion for rehearing, etc.; defendant's motion for leave to file its second motion for rehearing; defendant's second motion for rehearing; and plaintiff's response to defendant's motion for leave to file its second motion for rehearing and to defendant's second motion for rehearing. These various matters have been considered *en banc* and without oral argument. They are disposed of as follows:

1. Plaintiff's motion for rehearing is granted to the following extent and is otherwise denied:

(a). On page 11 of the slip opinion, second sentence, delete "of the airframe price" and substitute "of the total retail sale value (including engine and standard equipment)."

(b). In finding 467, last paragraph (as added by the court), third and seventh sentences, in both places delete "of the airframe price" and substitute "of the total retail sale value (including engine and standard equipment)."

(c). As provided in the original *per curiam* opinion the case remains remanded to the Trial Division for the computation of the precise amount of recovery, but we emphasize

that, insofar as the basic compensation is concerned,[1] the court feels that no further evidence or testimony is necessary but that the amount can be calculated from the court's opinion and findings, taken together with the material (except for the royalty-percentages and resulting monetary figures) in Judge Lane's findings with respect to "Royalty Bases" (Judge Lane's findings 475–516).[2]

(d). The trial judge to whom the case is assigned is directed to determine the amount of recovery as expeditiously as possible, and he may, in his discretion, call upon the parties for the written submissions suggested in paragraph B of plaintiff's motion for rehearing—or any other submissions or procedures the trial judge deems helpful in the expeditious computation of the amount of recovery.

(e). With respect to "Spare Parts" and "Experimental Use", the court deems those matters fully determined by Parts IV and VI, respectively, of its *per curiam* opinion.

2. Plaintiff's motion for leave to file a response to defendant's reply to plaintiff's motion for rehearing is granted and has been considered.

3. Defendant's first motion for rehearing is denied.

4. Defendant's motion for leave to file its second motion for rehearing is granted.

5. Defendant's second motion for rehearing is denied except that, in the paragraph of the *per curiam* opinion beginning on page 20 and ending on page 21, the second sentence is deleted in full, and the present third and fourth sentences are modified to read as follows: "But plaintiff did not include attorneys' fees in his requested reasonable and entire compensation before the trial judge, and no determination with respect to attorneys' fees, witness fees and expenses is called for from the court."

IT IS SO ORDERED.

[1] Evidence may possibly but not necessarily be called for with respect to the appropriate rate of delay compensation in 1976 and 1977.

[2] The court did not adopt those findings because many of them incorporated Judge Lane's determination of the reasonable royalty which differed from that the court determined.

Syllabus

546 F. 2d 386

# GIBRALTAR MANUFACTURING COMPANY v. THE UNITED STATES

[Nos. 597–71 and 364–72. Decided December 15, 1976]

ON THE PROOFS

**Renegotiation of contracts; redetermination of excessive profits.**— Plaintiff contracted for the manufacture and sale to the Government of sprockets which involve a technically complex process requiring an extensive understanding of metallurgy and mechanical engineering skills. Plaintiff's preeminence in this field was attributable to the exceptional energy and resourcefulness of its founder who personally controlled all aspects of production and sales. The Renegotiation Board determined that certain profits earned by plaintiff on its renegotiable business for fiscal years ended June 30, 1967 and 1968 constitute excessive profits. Plaintiff challenges the determinations, contending that it is due favorable consideration under 50 U.S.C. App. § 1213(e). The evidence shows that profits during the review years were 15.19% of sales and 23.02% of sales, respectively, and that the profit for the four previous normal years ranged from 4.21% to 7.5%. Plaintiff introduced major technical innovations and tripled its production in the first review year, employing multiple shifts. During the second review year, the technical innovation reduced the cost of labor and plaintiff's production continued. In both years plaintiff's profits were aided by price increases. It is *held* that plaintiff's performance during the review years merit favorable recognition for efficiency and for the technical complexity involved in the successful manufacture of sprockets, and that a preponderance of the evidence, including that delineating plaintiff's own profit experience in times of concededly normal operations, shows that plaintiff realized some excessive profits. It is also *held* that, on the basis of all the evidence, plaintiff realized excessive profits of $65,000 and $375,000 in fiscal years 1967 and 1968, respectively, before adjustment for state and federal taxes. The cases are remanded to the trial division for further proceedings under Rule 131(c).

**Renegotiation of contracts; redetermination of excessive profits; burden of proof.**

[1] A renegotiated contractor's alleged low pre-award profit estimates in contrast to the excess of the bids of the higher unsuccessful bidders, have no probative value to support a higher profit than the court deems otherwise justified. There is no statutory or regulation factor giving weight thereto.

War and National Defense ⟸ 59

Per Curiam

**Renegotiation of contracts; redetermination of excessive profits; calculation of profits.**

**[2] In executing its responsibilities under 50 U.S.C. App. § 1218, the court must sometimes select a course among possible alternatives in determining a standard of profit normalcy for a contractor's business, and may not accord the decision of the Renegotiation Board a presumption of correctness or treat it as evidence in support of its conclusion.**

War and National Defense ⇐ 59

**Renegotiation of contracts; redetermination of excessive profits; generally.**

**[3] In determining a renegotiated contractor's excessive profits, it is appropriate to look to the contractor's own prior experience as a general benchmark from which adjustments, designated by statute and regulation, are necessary to compensate for differing functional and economical factors as significantly affect profits in the period under review.**

War and National Defense ⇐ 59

**Renegotiation of contracts; redetermination of excessive profits; generally.**

[4] Although it has long been recognized that, in general, the Government should receive the major benefit of profits attributable to increased volume resulting from its own defense demand, the regulations recognize that the principle is subject to various qualifications, such as a contractor's exceptional effort resulting in an increase in volume of production.

War and National Defense ⇐ 59

*Walter A. I. Wilson*, for plaintiff. *John T. Koehler*, attorney of record. *Hudson, Creyke, Koehler & Tacke*, of counsel.

*Gerald L. Schrader*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

PER CURIAM: These cases, which were consolidated for trial, come before the court on plaintiff's and defendant's exceptions to findings of fact and recommended decision on October 14, 1975, by Trial Judge George Willi, in accordance with Rule 134(h). He redetermined after trial the alleged excessive profits received or accrued by plaintiff during its fiscal years ended June 30, 1967 and June 30, 1968, on defense

contracts and subcontracts, under 50 U.S.C. App. §§ 1212–18, as amended.

The case has been submitted on the briefs of the parties and oral argument of counsel. Upon consideration thereof, since the court agrees with the said recommended decision, as hereinafter set forth, with modifications to be explained, it affirms and adopts the said decision, as modified, as the basis for its judgment in this case.

The plaintiff argued orally that the then very recently announced decision of *Butkin Precision Mfg. Corp.* v. *United States*, 211 Ct. Cl. 110, 544 F. 2d 499 (1976), mandated a clearance herein. The cases do have similarities. Both involve small industrial concerns specializing in the production of one or a few difficult component parts of military hardware of the more complex varieties. Both were well managed and efficient, largely because of the unusual skills of the founder and owner. Both had a history of "normal" existence on a thin diet of profit, followed by greatly increased volume and profit during a brief flurry of war demand. Both pose difficulty in fair dealing in renegotiation under the fiscal year method, with danger of tunnel-visioned concentration on profitable years only, in disregard of thin years of preparation and recuperation. We determined that *Butkin* was entitled to a clearance, using the thin pre-war years as a base period of "normal" earnings but with very substantial upward adjustment in allowable profit expressly required by statute and regulation. We held, alternatively, that defendant failed in its burden of proof because of its failure to quantify or "cap" a demonstrated "contribution" that could have warranted a clearance all by itself, or with other favorable factor considerations. Plaintiff here does not fare so well. With a similar thin "starting point" it has not demonstrated its right to factor adjustment of such magnitude. Comparison of the factor analysis in this opinion with that will exemplify the statement. Defendant at the least of it has carried its burden of proof that excessive profits were realized in some substantial amount, equalling or exceeding for each year the minimum $40,000 determination prescribed in RBR § 1460.5(a).

The difficulty is to fix figures, as we must, with the "abouts" and "approximatelys" left off. Comparisons here are not very helpful. Those tendered by plaintiff, using IRS statistical composites, fail for the same reasons as those tendered by defendant in *Butkin*. About all else that is offered is the excess of other bids, over plaintiff's for items plaintiff supplied. These were unsuccessful bids, generating no awards. The probative value is therefore less than in *Butkin*, where higher bidders were also successful, in the sense that they were awarded subcontracts for the same components *Butkin* supplied, after *Butkin*'s capacity was fully utilized. Such comparisons have much more weight, for many obvious reasons.

Plaintiff's pre-award profit estimates of 2.45% to 5% are properly treated as not controlling. Plaintiff refused to allow defendant to verify its figures, which obviously were in the nature of seller's talk. There is no statutory or regulation factor giving weight to that. The defendant's negotiators disregarded it and projected that 10% of cost was a fair amount of profit for plaintiff, which the prices contracted for would allow. In *Mason & Hanger-Silas Mason Co.* v. *United States*, 207 Ct. Cl. 106, 518 F. 2d 1341 (1975), we held that plaintiff there could not avail itself of such expectation to support a higher profit than the court deemed otherwise justified. Nor can defendant use them here.

The trial judge inveighed against being asked to render a "jury verdict", in language we leave standing to explain our comment upon it. In *A. C. Ball Co.* v. *United States*, 209 Ct. Cl. 223, 531 F. 2d 993 (1976), we objected to the term "jury verdict" while holding that the broad brush approach there used was appropriate and necessary under the Act. We think that in executing our responsibilities under 50 U.S.C. App. § 1218, it will at times be necessary to select a course among possible alternatives, none of which the evidence obliges us to accept, or to reject. *Cf. The Conqueror*, 166 U.S. 110, 131 (1897); and *Meredith Broadcasting Co.* v. *United States*, 186 Ct. Cl. 1, 405 F. 2d 1214 (1968). In choosing among possible alternatives, none of which the evidence may not accord the Board decision a presumption of correct-

ness, or treat it as evidence in support of its conclusion. We do think we may take a sideways glance at it as a mere suggestion. This is what the trial judge did, we think properly. Unfortunately, he appears to have misconstrued the Board decision in some respects, and in making our own, we must look at it through our own eyes, not his.

The trial judge recommended that we adopt the Board's refund amounts, $125,000 for fiscal year ending June 30, 1967, and $475,000 for fiscal year ending June 30, 1968. However, when we examine the Board decision and the one recommended for us, we observe a discrepancy which may be summarized as follows:

| | *Board* | *Trial Judge* |
|---|---|---|
| Fiscal year ending June 30, 1967: | | |
| Sales | $2, 735, 338 | $2, 735, 328 |
| Profits | 488, 246 | 415, 356 |
| Percent profits to sales | 17. 8 | 15. 2 |
| Profits to be eliminated | 125, 000 | 125, 000 |
| Adjusted sales | 2, 610, 328 | 2, 610, 328 |
| Adjusted profits | 363, 246 | 290, 356 |
| Percent profits to sales | 13. 9 | 11. 1 |
| Fiscal year ending June 30, 1968: | | |
| Sales | 3, 749, 354 | 3, 749, 354 |
| Profits | 923, 198 | 862, 985 |
| Percent profits to sales | 24. 6 | 23. 0 |
| Profits to be eliminated | 475, 000 | 475, 000 |
| Adjusted sales | 3, 274, 354 | 3, 274, 354 |
| Adjusted profits | 448, 198 | 387, 985 |
| Percent profits to sales | 13. 7 | 11. 8 |

In the second line for each year, the trial judge's "Profits" were lower than the Board's because the Board had made salary disallowances which defendant did not insist on and did not obtain here. In some instances restoration of a disallowance may be partially or entirely offset by treating the contractor as a "high cost contractor," but in this case the restoration does not make the costs high enough to have any effect in factor analysis. Defendant believes the high salaries were justified. Logically it would seem that one who wished to follow the Board (as the trial judge did) would wish to leave the contractor with the same retained profit the Board did. This the trial judge's proposed decision does not do. Moreover a portion of Finding 34, which we have modified, asserts that the Board allowed 10.62% of sales for fiscal year 1967, and 10.35% of sales for fiscal year 1968. This apparently reflected the sales without adjustment, but by

RBR § 1460.3 the determination should "adjust" the sales by subtracting the excessive profit to be eliminated. We have made the adjustments in our calculations above, with respect to both the Board's decisions and the ones the trial judge proposes.

We conclude on all the evidence that the plaintiff realized excessive profits of $65,000 in its fiscal year 1967, and $375,000 in its fiscal year 1968, both figures before adjustment for State and Federal taxes. This summarizes as follows:

| | | |
|---|---|---|
| Fiscal year ending June 30, 1967: | | |
| Sales | $2, 735, 328 | |
| Profits | 415, 356 | |
| Percentage of profits to sales | | 15. 2 |
| Profits to be eliminated | 65, 000 | |
| Adjusted sales | 2, 670, 328 | |
| Adjusted profits | 350, 356 | |
| Percentage adjusted profits to adjusted sales | | 13. 1 |
| Fiscal year ending June 30, 1968: | | |
| Sales | $3, 749, 354 | |
| Profits | 862, 985 | |
| Percentage of profits to sales | | 23. 0 |
| Profits to be eliminated | 375, 000 | |
| Adjusted sales | 3, 374, 354 | |
| Adjusted profits | 487, 985 | |
| Percentage adjusted profits to adjusted sales | | 14. 4 |

Differing with the Board, we think that the plaintiff is entitled to a somewhat more favorable ratio of adjusted profit to sales in its fiscal year 1968 because only in the 1967 year it used Government-furnished machinery at a moderate if not nominal rental. The efficiencies resulting from plaintiff's technical innovations were fully realized only in the 1968 year. See Findings 10–14. We agree with the trial judge's opinion and findings respecting plaintiff's performance. They warrant upward adjustment of the retained profits over what the low base period earnings would indicate, to the extent allowed by the Board, and by us.

Accordingly, the court determines as a matter of law that the plaintiff realized excessive profits of $65,000 and $375,000, before adjustment for State and credit for Federal taxes on income, in the fiscal years ended June 30, 1967, and June 30, 1968, respectively.

Since we cannot determine from the record whether plaintiff has paid the Board refunds, or either of them, and

since our determination will require new calculations of the State tax adjustment (RBR § 1459.9) and the Federal tax credit (RBR § 1462.1 and ff.), we remand the cases to the trial division for Rule 131(c) proceedings rather than entering a money judgment at this time.

The opinion and findings of the trial judge, as modified by the court, are as follows:

WILLI, *Trial Judge:* The Renegotiation Board (the Board) determined that, before allowance for state and federal taxes on income, $125,000 of the profit earned by plaintiff on its renegotiable business for fiscal year ended June 30, 1967 and $475,000 of the profit earned by it on renegotiable business done in its fiscal year ended June 30, 1968 constituted excessive profits. Plaintiff brought this suit to challenge both of those determinations in their entirety. In turn, the Government contends in this *de novo* proceeding that a preponderance of the evidence demonstrates that plaintiff's excessive profits amounted to not less than $275,000 and $525,000 for the first and second years in suit, respectively.

This case is factually unique in that plaintiff has always specialized in exactly the same activity that generated all of its renegotiable revenues for the two years under review, *viz*, the manufacture and sale to the Government of final drive sprockets used for replacement purposes on such off-highway military vehicles as tanks, tank retrievers, gun carriers and personnel carriers.

Since 1961 plaintiff, a Michigan corporation, has conducted its business in its own plant in Port Huron, Michigan. Theretofore, beginning in approximately 1950, the business was located in rented quarters in Detroit.

The fundamentals of manufacturing a sprocket involve the flame-cutting of its rough configuration out of high carbon steel plate followed by a series of machining operations that are interspersed with various closely controlled applications of heat that are absolutely critical to the production of a sprocket of satisfactory machinability and end-product durability. The proper use and application of heat is the most technically complex aspect of the manufacturing process because it requires both an extensive understanding of metallurgy and the mechanical engineering skill necessary to ac-

complish a precise and efficient introduction of the heat that the metallurgy requires. In both of these areas plaintiff's president, Mr. Harvey Amoe, had outstanding competence.

The preeminence that plaintiff achieved in its specialty was attributable to the exceptional energy and resourcefulness of Mr. Amoe, who personally controlled all aspects of production and sales, assisted by his wife, Kathryn, who, as secretary-treasurer, assumed full responsibility for all record-keeping and related administrative aspects of the business.

Though there were two dozen or more firms, including such large concerns as Chrysler Corporation, that periodically responded to the Government's solicitations to supply it replacement sprockets, the evidence indicates that there was no potential supplier other than plaintiff who concentrated exclusively on that product line. That fact, coupled with Mr. Amoe's intense industry and great technical capability resulted in plaintiff's invariably being the low responsible bidder and therefore becoming practically the Government's sole supplier of replacement sprockets during the years under review. In that role, plaintiff delivered a product of consistently high quality and, considering the volume demands placed on its productive capacity during the years in suit as a result of Vietnam procurement requirements, did so with commendable punctuality.

Characterizing the fundamental concern of the Renegotiation Act of 1951, 50 U.S.C. App. §§ 1211–24 (1970), as amended (Supp. II 1972), as being with the reasonableness of prices rather than profits, plaintiff contends that none of its profits can properly be deemed excessive since all were earned by furnishing the Government a quality product at consistently lower prices than otherwise obtainable by it. Further, plaintiff points to the Armed Services Procurement Regulations[1] (ASPR) as reinforcing its conception of the central thrust of the Renegotiation Act.

---

[1] 32 C.F.R. § 3.806 (1974):

"• • • *Cost profit and price relationships.*

"(a) Where products are sold in the open market, costs are not necessarily the controlling factor in establishing a particular seller's price. Similarly where competition may be ineffective or lacking, estimated costs plus estimated profit are not the only pricing criteria. In some cases, the price appropriately may represent only a part of the seller's cost and include no estimate for profit or fee, as in research and development projects where the contractor is willing to

(Continued)

In response, defendant points to the language of the Renegotiation Act,[2] declaring Congressional policy to be the elimination of "excessive profits", not "unreasonable prices", and to various expressions in the relevant legislative history [3] to convincingly demonstrate that in the statutory context of renegotiation a price cannot be deemed reasonable if it yields the seller an excessive profit. The referenced ASPR does not impugn the validity of that principle in the area of procurement policy. Its message is just that a price does not become a reasonable one for the Government to pay simply because it is thought to yield the seller only a minimal profit. Total price of the end-product is of course the standard of competition in all markets, including those created by Government demand. *Paul* v. *United States*, 371 U.S. 245, 250–253 (1963).

Conceding that plaintiff is due some credit in both of the review years for contribution to the defense effort and in the second review year for efficiency, under the so-called statutory factors dealing with those matters [50 U.S.C. App. § 1213(e)(4)], defendant relies basically on a comparison of plaintiff's profit performance in the review years with that of the year immediately preceding them to carry its burden of proving the existence and extent of excessive profits. *Lykes Bros. S.S. Co.* v. *United States*, 198 Ct. Cl. 312, 327, 330, 459 F. 2d 1393, 1401–1403 (1972).

Understandably, in view of the dramatic profit increase in the review years, but not persuasively, plantiff vigorously attempts to discredit the significance of a contractor's past

---

(Continued)
share part of the costs in other cases, price may be controlled by competition as set forth in § 3.805–1(a). The objective of the contracting officer shall be to negotiate fair and reasonable prices in which due weight is given to all relevant factors, including those in § 3.101.

"(b) Profit or fee is only one element of price and normally represents a smaller proportion of the total price than do such other estimated elements as labor and material. While the public interest requires that excessive profits be avoided, *the contracting officer should not become so preoccupied with particular elements of a contractor's estimate of cost and profits that the most important consideration, the total price itself, is distorted or diminished in its significance.* Government procurement is concerned primarily with the reasonableness of the price which the Government ultimately pays, and only secondarily with the eventual cost and profit to the contractor." (Emphasis added.)

[2] 50 U.S.C. App. § 1211.

[3] H. Rep. No. 7, 82d Cong. 2d Sess., pp. 2, 5; 97 Cong. Rec., Part 1, pp. 593, 594, 607, 1344, 1346, 1437.

performance in gauging the question of excessive profits for a current period. The question, of course, is not whether the permissible amount of a contractor's present-day profits is to be straitjacketed by his own prior experience but whether that experience is cognizable as a general benchmark from which adjustments appropriate under the various statutory factors are to be made.

Because plaintiff's operations during the review years are distinguishable from those of its entire previous business history only by substantial differences in volume, the selection of a profile of profit normalcy from that earlier history is particularly apt in this instance.

The Act directs that "In determining excessive profits * * * there shall be taken into consideration * * * Reasonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products, * * * ." 50 U.S.C. App. § 1213(e)(1). Regarding the relevance of a profitability norm in the contractor's own prior history, the Board's interpretive regulation provides: "Comparison will be made with the contractor's own costs and profits in previous years and with current costs and profits of other contractors,[4] if such information is available." 32 C.F.R. § 1460.10(b)(1) (1974). Informed observers and practitioners have long recognized the soundness of looking to the contractor's own prior experience as an indication of the starting point to which should be made those adjustments, designated by statute and regulation, necessary to compensate for such differing functional and economic factors as significantly affect profits in the period under review. Senate Hearings on Sec. 403 of Pub. L. 528 (To Amend Title VII of the Revenue Bill of 1943—Renegotiation of Contracts) (1943) at 6; N. H. Jacoby & J. F. Weston, *Profit Standards for Renegotiation*, in PROCUREMENT AND PROFIT RENEGOTIATION, (1960) 121, note 19, at 144.

In his testimony, Mr. Amoe affirmatively identified plaintiff's fiscal years ended June 30, 1963, 1964 and 1966 as periods

[4] The record herein contains no evidence of the costs or profits of any other contractor shown to be at all functionally comparable to the plaintiff either before or during the review years.

characteristic of normal volume and profits for it. The evidence also shows that, while somewhat more profitable, plaintiff's fiscal year ended June 30, 1965 readily fits into the same pattern of normalcy.

Mrs. Amoe testified that an annual output of 12,000 sprockets would constitute normal volume for plaintiff.

In each of the fiscal years ended June 30, 1963 through June 30, 1966 plaintiff produced 16,094, 15,417, 19,815 and 17,361 sprockets, respectively. Finding 14, *infra.*

For those years plaintiff's pre-tax profits averaged 6.01 percent of sales, ranging from a low of 4.21 percent in fiscal 1964 to a high of 7.57 percent in fiscal 1965. Findings 17, 19, *infra.*

In the first review year, fiscal 1967, output rose to 53,616 sprockets, sales to $2,735,328.44 and pre-tax profit accounted for 15.18 percent of sales. Findings 14, 17, *infra.* Thus, dollar volume and profits for that year rose 188 percent and 545 percent, respectively, over the preceding year.

In the second review year, fiscal 1968, sprocket volume further increased to 58,598 and pre-tax profits to 23.02 percent of sales. Findings 14, 17, *infra.* As contrasted with the 1966 fiscal year, sales increased 295 percent while profits ballooned 1,240 percent.

The evidence is that although plaintiff introduced two major technical innovations during the first review year, both were undergoing trial and error adjustments throughout that year and neither, therefore, served to increase efficiency until the following year. Findings 11–13, *infra.* In all other respects, manufacturing operations were performed in the first review year in the same manner that they had been throughout at least the three immediately preceding years, if not longer. It appears, therefore, that production was trebled in the first review year by resort to multiple work shifts, not by technological advances that increased efficiency. This is reflected by the fact that plaintiff's ratio of direct labor cost to sales revenue showed little or no improvement in the first review year as compared with the next three preceding years. Finding 26, *infra.* Increased volume in that year did, however, yield a significant reduction in the per-

centage of sales revenue consumed by the burden items of general and administrative expense. Finding 17, *infra.*

Aside from the effect of increased volume on the unit cost of overhead, the evidence indicates that plaintiff's pre-tax profits in the first review year were materially benefited by price increases that it was able to obtain on three of the larger and, consequently, higher-priced sprockets in its product line. Finding 25, *infra.*

In the above circumstances defendant charges that not less than $275,000 of plaintiff's pre-tax profit of $415,355.83 must be considered excessive. That would leave plaintiff with a pre-tax profit of approximately 5.7 percent of sales—a lesser rate of return than it achieved in each of the two previous years and well below the average of the four preceding years. Finding 17, *infra.* To support this view defendant attributes virtually none of plaintiff's profit increase in the first review year to improved efficiency or, except for minimal recognition for contribution to the defense effort, to any other aspect of the so-called statutory factors justifying the retention of additional profits.

Although it has long been recognized that, in general, the Government should receive the major benefit of profits attributable to increased volume resulting from its own demand,[5] the Board's own interpretive regulations recognize that the principle is subject to various qualifications. For example, 32 C.F.R. § 1460.10(b)(3) (1974), provides in part:

> Favorable consideration will be given to an increase in volume of production for defense purposes. On the other hand, when the Government's demand has enabled the contractor to increase his sales *without exceptional effort* and without corresponding increases in costs, decreased unit costs result, and the Government should normally get the principal benefit in more favorable prices, or in renegotiation. [Emphasis added.]

The record is clear that it was only the exceptional effort put forth by Mr. and Mrs. Amoe and plaintiff's entire work

[5] 97 Cong. Rec., Part 1, pp. 594, 1324 (1951). C. G. Blough, *Renegotiation Standards and Practices,* 10 Law and Contemp. Prob., 276, 298 (1943); J. T. Koehler, *An Imaginary Renegotiation Case—How Statutory Factors Are Applied,* speech delivered to the American Management Association, 1952, reprinted in *The Renegotiation Guide,* (1957), 59, 59–60.

force that enabled it to triple its production in the first review year. There is no suggestion that the performance in that year represented anything less than full realization of the maximum potential of its productive facilities.

Contrary to defendant's assertion, plaintiff's performance in the first review year clearly merits the favorable recognition for efficiency that is mandated by the Act. 50 U.S.C. App. § 1213(e). The Board's definitive regulation states [32 C.F.R. § 1460.9(b)]:

> Favorable recognition must be given to the contractor's efficiency in operations, with particular attention to the following:
>
> (1) Quantity of production; for example, in relation to available physical facilities; meeting production schedules * * *; maximum use of available production facilities.
>
> (2) Quality of production; for example, maintenance of standards of quality; rejection record; reported mechanical or other difficulties in the use or installation of the product.
>
> * * * * *

Equally apparent on the evidence is the fact that plaintiff is due favorable consideration under 50 U.S.C. App. § 1213 (e)(5) for the technical complexity that is involved in the successful manufacture of sprockets. The demanding requirements [6] for the heat-treatment necessary to properly harden the sprockets in desired areas, but only in these areas, is clearly illustrative of the type of complexity envisioned by this factor. Also involved is the absolute necessity of machining the sprockets to extremely close tolerances. The pertinent Board regulation provides, in part [32 C.F.R. § 1460.14(b)(1)]:

> Consideration will be given to the character of the business of the contractor. The manufacturing contribution will vary with the nature of the product and the degree of skill and precision required in the work performed by the contractor. The relative complexity of the manufacturing technique and the relative integration of the manufacturing process are the basic considerations in evaluating this factor.

[6] Finding 9, *infra*.

The net of the total situation for the first review year is that when assimilated to the relevant statutory criteria, a preponderance of the evidence, including that delineating its own profit experience in times of concededly normal operations, shows that plaintiff did realize some excessive profits. It is equally clear, however, that under the same criteria not all of its profits above 5.7 percent of sales were excessive, as defendant would have it.

The situation is not materially different for the second review year.

Again, unless the Renegotiation Act is deemed inapplicable as a matter of law to contractors who typically produce goods of acceptable quality at prices lower than obtainable elsewhere by the Government, a proposition that is insupportable for reasons previously given, some part of the pretax profit of $862,984.80 earned by plaintiff in its fiscal year ended June 30, 1968 was clearly excessive. The evidence shows[7] that less than $100,000 of that unprecedented profit resulted from reductions in the unit cost of direct labor that presumably were made possible by technological advances perfected by the close of the preceding year.[8] As in the case of the first review year, it appears that price increases[9] obtained by plaintiff on three of the large-type sprockets in its product line were once again primarily responsible for a rate of return on sales that was more than three times greater than that achieved by plaintiff in f.y.e. June 30, 1965, the best year that it ever had prior to the period under review.

While the technological efficiency factor recognized by defendant for the second review year prompted it to increase the margin of profit to which it agrees plaintiff was entitled, to approximately 9 percent of sales (rather than 5.7, as in the preceding year), it is apparent that it still failed to accord plaintiff all of the favorable consideration due it under the statutory factors. For example, defendant's approach to the second review year makes no allowance for the earnings

[7] Finding 26, *infra*.
[8] Findings 11–13, 27, *infra*.
[9] Finding 27, *infra*.

credit due plaintiff for complexity involved in its manufacturing technique. That factor is equally apposite to both of the review years.

In sum, as to both of the years in suit, the record is entirely adequate to permit an intelligible discernment of a basic standard of profit normalcy for plaintiff's business and to identify those statutory factors entitling it to additional profit allowances for review year operations. The evidence does not, however, provide a tenable basis for separately translating each of the operative factors into a reasonably definite dollar amount. In these circumstances, to invoke the frequently abused expendient of a so-called "jury verdict" to reach a superficially determinate result would be little short of pure sophistry. In its legitimate form a "jury verdict" is not an unqualified license to guess. *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.*, 161 F. 2d 413, 449–451 (2d Cir. 1947) (opinion of Frank, J., dissenting in part). A realistic alternative is provided by the evidence.

Almost half of the sprockets that the Government bought from plaintiff during the two review years, some 43,774 in all, were procured under negotiated contracts that were let because of a lack of bidder interest or of adequate price competition in such bids as were received in response to formal advertising solicitations. 10 U.S.C. § 2304; 32 C.F.R. §§ 1.300–2, 1.300–3 (1974).

As a prerequisite to the issuance of a negotiated contract the ASPR's provide: "Some form of price or cost analysis is required in connection with every negotiated procurement action." 32 C.F.R. § 3.807–2(a) (1974). In advance of each of the negotiated contracts that it received in the review years, therefore, plaintiff submitted a breakdown-type statement of the costs that it expected to incur and the profit that it expected to earn on the contemplated procurement. In these submissions plaintiff variously projected its margin of profit as ranging between 2.45 percent and 5 percent of selling price. On the negotiated contracts as a whole, plaintiff's projected profit margin averaged well under 3.5 percent of selling price. In the course of performance or afterwards it never qualified or rescinded these representations as to its profit expectations. Although Mr. Amoe consistently denied the Government

access to plaintiff's plant operations for purposes of verifying the accuracy of its cost projections, the increment of profit was never a subject of contention. In fact, evaluating plaintiff's cost and profit submissions in the process of attempting to arrive at an acceptable unit price to be used for an award, the procurement representatives uniformly disregarded plaintiff's profit projections in favor of their own conception of a measure of profit that was fair and equitable recompense for the undertaking involved. They uniformly selected 10 percent of total cost as the proper measure of a fair profit. Finding 24, *infra*. Although the Government was in urgent need of the sprockets covered by the negotiated contracts awarded plaintiff, there is no suggestion in the record that this standard of reasonableness for profits was the product of duress, fraud or mistake, or that for any reason the procuring authority ever, even at trial, came to regard it as excessive.

## FINDINGS OF FACT

**1.** Plaintiff, a Michigan corporation whose plant and offices were located in Port Huron during the two fiscal years in issue, was formed in 1952 to manufacture and sell a single product line; final drive sprockets for such off-highway military vehicles as tanks, tank retrievers, gun carriers and personnel carriers. Instead of attempting to sell these sprockets to vehicle manufacturers for use as original equipment components, plaintiff has concentrated its efforts on the replacement market in which the U.S. Government is the sole customer.

**2.** Harvey Amoe, assisted by his wife, Kathryn, founded plaintiff and has been the principal moving force in its subsequent development. Although during the period in suit Mr. Joseph F. Clavenna owned something more than one-third of plaintiff's stock and served as its vice-president, Mr. and Mrs. Amoe have always held the controlling interest. As plaintiff's president Mr. Amoe has personally directed all aspects of production and sales thoughout while Mrs. Amoe, serving as secretary-treasurer, assumed full responsibility for all record-keeping and administrative phases of the business.

3. Mr. Amoe is a dynamic and highly individualistic person with a great degree of mechnical skill and inventiveness. He received his technical education, beginning at age 15, from the Henry Ford Trade School where the curriculum consisted of an intensive three-year combination of predominantly technical academics and work experience. After completing that course he served his apprenticeship working for the Ford Motor Co. and ultimately rose to the position of general manager of Quality Tool and Die Co., a Ford subsidiary. He held that job until the early 1940's when he first went to Port Huron and attempted to establish his own toolmaking business under the name of Gibraltar Machine Co. The effort proved unsuccessful, however, because the area did not have the skilled toolmakers and machinists necessary for such precision work. Mr. Amoe adjusted to this labor situation by changing the format of his business to that of a production shop. Such a business produces particular articles on a job-lot basis in response to the customer's specifications and quantity requirements. For example, the business made magnetic field rings used as components in the manufacture of electrical generators.

4. It was in approximately 1942 that Mr. Amoe first began making final drive sprockets for the military. He did this in the basic capacity of a second-tier subcontractor for Borg-Warner Co. The opportunity arose when he learned that the Ingerosol Division of Borg-Warner had obtained a Navy contract to build LVT–3 vehicles (landing vehicle, tank). He felt that he had the know-how to make the final drive sprockets for these vehicles but he did not have the capital to finance their production. He therefore contacted Jones & Laughlin Steel Co. and interested that firm in bidding as a subcontractor to furnish the sprockets, Jones & Laughlin to supply the steel and Amoe to perform the fabrication. The arrangement proved mutually satisfactory and continued until military procurement dried up at the end of World War II. There being no further demand for sprockets, Mr. Amoe turned to making industrial patterns for foundry use. By the late 1940's it became apparent that pattern-making was not going to generate sufficient earnings to justify continuing the business. Accordingly, the Gibraltar Machine Co. was liquidated. In 1950, after a brief and unsatisfactory experience in the hotel

business, Mr. Amoe relocated in Detroit. While there he learned that General Motors' Cadillac Tank Plant at Cleveland, Ohio, had been awarded a large contract for Bulldog Walker Tanks. He promptly approached Jones & Laughlin, with whom he had earlier associated successfully in the production of sprockets for the LVT–3, to determine whether it would be interested in jointly endeavoring to secure a subcontract for sprockets to be installed on the Walker as original equipment. Jones & Laughlin was receptive but the effort to obtain the business was not successful. Mr. Amoe later learned that a subcontract for the Walker sprockets was let to the Morris Chain Division of Borg-Warner. Morris Chain, it developed, was unable to perform the subcontract and turned to Jones & Laughlin for assistance because it had heard of the latter's earlier success in supplying sprockets for the LVT–3s. In turn, Jones & Laughlin referred the Borg-Warner people to Mr. Amoe as the person who had the necessary technical know-how. They contacted him and attempted to get the benefit of that know-how either by purchasing it outright from him or by enlisting his services as an employee. He flatly rejected these overtures in favor of simply obtaining a subcontract from Morris Chain to produce the sprockets. He persevered and received the subcontract, which he performed satisfactorily in rented machine shop facilities that he had obtained in the Detroit area. It was at this time that Mr. Amoe first became aware of the potential market for replacement sprockets, a market that would enable him to deal directly with the buyer (the U.S. military) and to thereby be relieved of the frustrations of attempting to secure original equipment subcontracts from the large commercial concerns who held the prime contracts for off-highway military vehicles. He thereafter concentrated on bidding competitively to supply the military's replacement sprocket needs under fixed price contracts.

5. Inadequate financing handicapped Mr. Amoe's early efforts at securing replacement sprocket contracts from the Government. For example, his was the low bid on an invitation to supply 20,000 replacement sprockets for the M–47 tank. He did not get the contract, however, because a preaward investigation disclosed that he was unable to finance acquisition of the necessary steel plate from which the

sprockets were to be made. That contract was awarded to the Michigan Stove Co., which elected to perform it through its Metal Fabricating subsidiary. The subsidiary's plant was located in Detroit, near the rented space occupied by Mr. Amoe. Metal Fabricating experienced considerable difficulty in producing sprockets that met the applicable specifications. When Mr. Amoe learned of this he approached Metal Fabricating and offered to fill the commitment under a subcontract. Though Metal Fabricating attributed its difficulties to faulty material, Mr. Amoe found that the real problem was lack of technical know-how, particularly in the area of the heat treatment required to harden the sprockets in the proper places. He had conceived and built a flame-hardening apparatus by which this could be done properly and much more economically than by alternative means of electric induction hardening equipment. The result was that Mr. Amoe succeeded in obtaining a subcontract from Metal Fabricating at the same price that he had used in his unsuccessful bid to the Government. While this arrangement was economically satisfactory to Mr. Amoe, he soon found that he was subject to significant end-product inspection difficulties that resulted from skepticism that Metal Fabricating had engendered in Government representatives in the course of its faulty efforts to perform. Although these circumstances caused frustrating inspection delays and considerable inconvenience for Mr. Amoe in completing his subcontract, the extensive contact that he had with Government procurement officials in the course of overcoming the problems that he inherited from Metal Fabricating earned him the lasting confidence and respect of these officials.

**6.** Plaintiff continued operating in rented quarters in Detroit until 1961 when it purchased an old but adequate plant facility on the St. Clair River in Port Huron and relocated there.

**7.** The finished weight of the various drive sprockets manufactured by plaintiff ranged from 21 pounds to 121 pounds. The sprockets are cut out of high carbon steel plate ranging in thickness from 1½ to 1¾ inches and weighing 3,210 pounds. With the end-product yield from that raw material approximating only 33 percent, it is seen that

fabrication entails the in-process movement of relatively heavy and cumbersome articles. This factor is important because, in plaintiff's operation at least, the bulk of the required handling is manual. That fact, coupled with the heat generated by the fabrication process, creates a physically demanding and generally unattractive work environment. Thus, the recruitment and retention of a competent and productive work force has always been a chronic problem for the plaintiff and one that tended to increase in proportion to volume output requirements.

8. The same basic procedures were required for manufacturing all of the sprockets in which plaintiff dealt. They can be summarized as follows:

a. The rough configuration of the sprocket is cut out of a steel plate by acetylene burning.

b. The cut form is heat-treated in order to give it a uniform and proper texture.

c. After surface scale is removed by sandblasting, the center-hole is counterbored and the lug areas drilled and tapped.

d. The tooth-pointing needed to properly engage the sprocket with the driven track is then performed and the tooth contours milled smooth and freed of burrs.

e. The tooth contours, the primary wear areas on the sprocket, are alternately heat-treated and quenched to create requisite hardness there without imparting the same to the teeth themselves. The entire sprocket is then stress-relieved by a uniform application of heat.

9. The evidence uniformly shows that the proper application of heat is the most critical aspect of sprocket manufacture, the object being to achieve necessary machinability and end-product durability without producing the thermal cracking that results from metallic inclusions of oxides and silicates when heat is improperly applied. It was primarily to this general subject that Mr. Amoe referred when he testified that "* * * there are a few items in manufacturing sprockets that are tricks, and it's very tricky if you don't know what you're doing." The evidence is equally clear that in this and all other respects of sprocket manufacturing, Mr. Amoe knew precisely what should be done and had a very sound and workable approach as to how to do it.

10. In the course of his years of experience in sprocket manufacturing Mr. Amoe developed various innovations that materially increased efficiency and thereby yielded consequent reductions in production time and cost. All but two of these innovations were conceived and perfected prior to 1964.

First, Mr. Amoe modified the feed mechanism on the burning torches used to cut the basic sprocket configuration from steel plate so as to increase the torches' cutting capacity, thereby reducing the burning time required for each sprocket.

Next, he found that because of the severe impact vibration involved, the old fashioned type of belt-driven lathe was far superior to the modern and more expensive gear-driven lathes for tooth-pointing.

Mr. Amoe developed two concepts that achieved substantial efficiency improvement and cost reduction in the milling of the tooth contour or pocket area of the sprockets. First, he adapted conventional horizontal milling machines in a manner that permitted them to operate with a vertical feed (rather than a longitudinal feed and a cross feed) so that, depending on size, four to eight or nine sprockets could be loaded onto a precision fixture and milled simultaneously. Second, he designed and made a special purpose cutting tool for this operation that had a substantially greater wear life between sharpenings than commercially available tools which were, in addition, more than three times as costly in the first instance. He also modified a standard type of profile grinder so that it could sharpen these in-house cutting tools in approximately one-fifth the time required to sharpen the commercially available tools.

Finally, Mr. Amoe designed and built an apparatus for the critical process of imparting the necessary hardness to the contour area of sprockets while at the same time leaving the core portion of the teeth soft and thereby able to absorb the impact of stones and other hard foreign materials picked up in the track area, without breaking. To accomplish this he devised an electronically controlled device for applying flame heating and quench cooling in carefully controlled cycles that contacted the sprockets at precisely the proper locations. The alternative means of hardening the desired areas of the

sprockets involves the use of electric induction hardening machines. Such equipment is extremely costly and far more difficult to operate within the close tolerances needed to confine hardness to the contour area so that none of the teeth become brittle.

**11.** The two other innovations conceived and perfected by Mr. Amoe were instituted during the period in suit. Both materially increased efficiency.

In the period May–June, 1967, after a period of trial and error that consumed most of a year, Mr. Amoe perfected a hooding technique by which sprockets could be withdrawn from the normalizing furnace while still hot instead of remaining in the furnace until totally cool. Normalizing is essential to remove the stresses that are created in high carbon steel when it is permitted to cool in the open air after being subjected to the burning process by which the rough sprocket form is cut out of the steel plate raw material. Before perfection of the hooding technique the capacity of plaintiff's furnace was limited to one charge of rough cut sprockets per 24 hours. The procedure was to maintain the furnace at 300–400 degrees while it was being loaded with sprockets. After loading was completed the heat was increased to full normalizing temperature and maintained at that level for approximately one hour per inch of sprocket thickness. Thereafter the heat was gradually diminished until completely shut off. The sprockets then had to remain in the furnace until the furnace and the entire charge of sprockets in it reverted to approximately normal temperature without exposure to outside air. It was this procedure that consumed 24 hours and since normalizing prior to machining was essential to the manufacture of an acceptable sprocket, this step represented an absolute bottleneck in plaintiff's operations. Mr. Amoe was able to quadruple the daily sprocket capacity of the furnace by devising a hooding apparatus that permitted withdrawal of the sprockets from the furnace at full normalizing temperature thereby permitting the furnace to be immediately reloaded with a fresh charge of sprockets and also permitting it to operate continuously at high temperature without the necessity for intermittent temperature reduction to permit slow cooling of the normalized sprockets.

The other innovation perfected by Mr. Amoe during the period in suit was the use of Potter & Johnson (P&J) horizontal automatic turret lathes, varying in length from 12 to 18 feet, to counterbore and champfer (remove burrs) the center hole of a sprocket all in a single, fully automatic operation that required only a single tool setting. Prior to the application of this technology these operations were performed separately and the counterboring was done on vertical turret lathes or boring mills that not only operated at a significantly smaller capacity but required a much more skilled operator; for example, one capable of making precise micrometer readings. The P&Js used by plaintiff were equipped with six stations, *viz*, six separate places where tooling could be applied to the material being machined. A turret, timed with a cam, independently and sequentially approached each of the six separate tooling stations, automatically performed its assigned operation at that station, and then backed off and moved to the next station. The P&Js were also equipped with a cross-slide which permitted the addition of the tooling necessary to concurrently perform the chamfering operation. By replacing the traditional methods of counter-boring and champfering with the P&Js became essentially a loading and monitoring function, since all machining was done automatically by fixed-position tools. This was particularly advantageous to plaintiff because of the extreme shortage of available skilled labor in the Port Huron area.

**12.** Plaintiff bought its first P&J on March 28, 1966. It bought three more P&Js in April of the same year. Because of material shortages, the electrical work necessary to place these machines in operation required 4–6 weeks. In addition, because of the special-purpose use to which the machines were to be put, it was necessary for plaintiff to make all of the tooling required for them. After this was done and the machines placed in service, the process of eliminating the "bugs" began. Because the technology was new and because of the large volume of sprockets that plaintiff was attempting to process with those machines, tool breakage and equipment breakdowns were frequent in the early stages of this operation. At the time the Government's need for replacement sprockets in Vietnam fully taxed plaintiff's productive capacity. In order to alleviate down time in the counterboring phase of opera-

tions the Government leased three P&Js, that were in new condition, to plaintiff for a reasonable rental fee. At the same time the Government provided plaintiff with some needed drill presses. The Government-furnished P&Js furnished valuable backup assistance until May, 1967, when plaintiff purchased two more P&Js in the commercial market.

**13.** Mr. Amoe testified that it was not until May, 1967 that all "bugs" had been effectively eliminated from the P&J innovation. He testified that while P&J efficiency gradually improved, beginning in the fall of 1966, it was not until May, 1967 that experience gained from trial and error had rendered the process essentially "bug-free" and fully productive.

**14.** Plaintiff produced and sold the following quantities of sprockets during each of the fiscal years indicated below:

| *Fiscal year ending* | |
|---|---|
| June 30, 1962 | 5, 513 |
| June 30, 1963 | 16, 094 |
| June 30, 1964 | 15, 417 |
| June 30, 1965 | 19, 815 |
| June 30, 1966 | 17, 361 |
| June 30, 1967 | 53, 616 |
| June 30, 1968 | 58, 598 |
| June 30, 1969 | 3, 717 |
| June 30, 1970 | 9, 466 |
| June 30, 1971 | 6, 635 |
| June 30, 1972 | 800 |

**15.** Mrs. Amoe testified that in her opinion a normal year in plaintiff's business, from the standpoint of annual volume of sprocket output, would be one in which production averaged approximately 1,000 sprockets per month.

**16.** In response to a question specifically calling for the identification of a period prior to the review years (fiscal years ended June 30, 1967 and June 30, 1968) that plaintiff regarded as normal in the conduct of its business, Mr. Amoe specified the fiscal years ended June 30, 1963 and June 30, 1964 as representing years of normal operations. He later expanded this specification to include its fiscal year ended June 30, 1966. The evidence indicates that plaintiff's operations for the fiscal year ended June 30, 1965 were equally representative of normalcy for it.

**17.** For each of the years indicated, plaintiff's sales, cost of goods sold, general and administrative expense and pretax net profit (expressed both in dollar amount and as a percentage of sales) were as follows:

## COMPARATIVE STATEMENT OF REVENUES, COSTS AND EARNINGS

| Item | Fiscal year ending June 30, 1963 | | Fiscal year ending June 30, 1964 | | Fiscal year ending June 30, 1965 | |
|---|---|---|---|---|---|---|
| Sales | $667,873.31 | 100% | $604,516.32 | 100% | $898,179.34 | 100% |
| Cost of Goods sold | 584,461.70 | 87.51% | 506,176.50 | 83.73% | 749,601.20 | 83.46% |
| General and administrative | 53,627.04 | 8.03% | 72,889.78 | 12.06% | 80,589.52 | 8.97% |
| Pre-tax profit | 29,784.57 | 4.46% | 25,450.04 | 4.21% | 67,988.62 | 7.57% |

| Item | Fiscal year ending June 30, 1966 | | Fiscal year ending June 30, 1967 | | Fiscal year ending June 30, 1968 | |
|---|---|---|---|---|---|---|
| Sales | $949,354.91 | 100% | $2,735,328.44 | 100% | $3,749,354.30 | 100% |
| Cost of goods sold | 799,457.35 | 84.21% | 2,193,502.27 | 80.19% | 2,745,604.17 | 73.23% |
| General and administrative | 85,520.36 | 9.01% | 126,470.34 | 4.62% | 140,765.33 | 3.75% |
| Pre-tax profit | 64,377.20 | 6.78% | 415,355.83 | 15.18% | 862,984.80 | 23.02% |

Findings of Fact

**18.** For each of the years indicated, plaintiff's opening net worth and its pre-tax net profit (expressed both in terms of dollar amount and as a percentage of opening net worth) were as follows:

COMPARATIVE STATEMENT OF OPENING NET WORTH AND ANNUAL EARNINGS

| | *Fiscal year ending* | | |
|---|---|---|---|
| *Item* | *June 30, 1963* | *June 30, 1964* | *June 30, 1965* |
| Opening net worth | $93, 923. 78 | $110, 562. 68 | $126, 917. 78 |
| Pre-tax profit | 29, 784. 57 | 25, 450. 04 | 67, 988. 62 |
| Profit as percent of opening net worth | 31. 71 | 23. 02 | 53. 57 |

| | *Fiscal year ending* | | |
|---|---|---|---|
| *Item* | *June 30, 1966* | *June 30, 1967* | *June 30, 1968* |
| Opening net worth | $146, 440. 71 | $166, 660. 61 | $309, 974. 27 |
| Pre-tax profit | 64, 377. 20 | 415, 355. 83 | 862, 984. 80 |
| Profit as percent of opening net worth | 43. 96 | 249. 22 | 278. 41 |

**19.** For the four-year period, fiscal year ended June 30, 1963 through the fiscal year ended June 30, 1966, plaintiff's average annual sales, cost of goods sold, general and administrative expense and pre-tax net profit (expressed both in dollar amount and as a percentage of sales) were as follows:

STATEMENT OF AVERAGE REVENUES, COSTS AND EARNINGS FOR FISCAL YEAR ENDING JUNE 30, 1963 THRU FISCAL YEAR ENDING JUNE 30, 1966

| | *Amount* | *Percent of Sales* |
|---|---|---|
| Sales | $779, 980. 97 | 100 |
| Cost of Goods Sold | 659, 949. 20 | 84. 61 |
| G&A Expense | 73, 156. 67 | 9. 38 |
| Pre-tax Profit | 46, 900. 11 | 6. 01 |

**20.** For the two-year period, fiscal year ended June 30, 1963 and fiscal year ended June 30, 1964, plaintiff's average annual sales, cost of goods sold, general and administrative expense and pre-tax net profit (expressed both in dollar amount and as a percentage of sales) were as follows:

STATEMENT OF AVERAGE REVENUES, COSTS AND EARNINGS FOR FISCAL YEAR ENDING JUNE 30, 1963 AND JUNE 30, 1964

| | *Amount* | *Percent of Sales* |
|---|---|---|
| Sales | $636, 194. 80 | 100 |
| Cost of Goods Sold | 545, 319. 10 | 85. 72 |
| G & A Expense | 63, 258. 41 | 9. 94 |
| Pre-tax Profit | 27, 617. 30 | 4. 34 |

**21.** For the two-year period, fiscal year ended June 30, 1965 and fiscal year ended June 30, 1966, plaintiff's average annual sales, cost of goods sold, general and administrative expense and pre-tax profit (expressed both in dollar amount and as a percentage of sales) were as follows:

STATEMENT OF AVERAGE REVENUES, COSTS AND EARNINGS FOR FISCAL YEAR ENDING JUNE 30, 1965 AND JUNE 30, 1966

| | *Amount* | *Percent of Sales* |
|---|---|---|
| Sales | $923, 767. 12 | 100 |
| Cost of Goods Sold | 774, 529. 30 | 83. 84 |
| G & A Expense | 83, 054. 94 | 8. 99 |
| Pre-tax Profit | 66, 182. 91 | 7. 17 |

**22.** Prior to the review years, the most profitable year in plaintiff's history was the fiscal year ended June 30, 1965. The $67,988.62 pre-tax profit that it earned in that year represented a 7.57% return on sales and a 53.57% return on opening net worth. In the fiscal year ended June 30, 1967, the first review year, plaintiff's actual pre-tax profit of $415,-355.83 represented a return of 15.18% on sales and 249.22% on opening net worth. As contrasted with the respective rates of return on sales and net worth achieved for f.y.e. 6/30/65, that profit exceeded 7.57% of f.y.e. 6/30/67 sales by $208,-291.47 and 53.57% of f.y.e. 6/30/67 opening net worth by $326,075.74. For the fiscal year ended June 30, 1968, the second review year, plaintiff's actual pre-tax profit of $862,984.80 represented a return of 23.02% on sales and 278.41% on opening net worth. As contrasted with the respective rates of return on sales and net worth attained for f.y.e. 6/30/65, that profit exceeded 7.57% of f.y.e. 6/30/68 sales by $579,158.68 and 53.7% of f.y.e. 6/30/68 opening net worth by $696,931.58.

**23.** Although it appears that throughout the 1960's, there were at least two dozen firms, including such large ones as the Chrysler Corporation, that held themselves out as manufacturers of the type sprockets in which plaintiff dealt, the evidence is that it was only the plaintiff who concentrated exclusively on that product line. That specialization, combined with the drive, technical competence and inventiveness of Harvey Amoe, placed plaintiff in a preeminent competi-

tive position from the standpoint of costs and efficiency. It was undoubtedly these factors that accounted for the fact that plaintiff was consistently the low bidder for the Government's replacement sprocket business and, with a single minor exception, its sole supplier of sprockets during the review years.

24. The evidence shows that the profit margins realized by plaintiff on sprocket sales during the review years vastly exceeded those that it projected to the Government when it obtained much of the business that was let on a negotiated basis because of the lack of adequate bidding competition. As earlier noted, plaintiff achieved pre-tax profits of 15.18% and 23.02% on sales in f.y.e. 6/30/67 and 6/30/68, respectively. Finding 16, *supra*. These profit rates were three to as much as ten times greater than the rate of profit that plaintiff projected to the Government in the Certificates of Cost or Pricing Data that it was required to submit in justification of the unit prices that it proposed for negotiated contracts that were ultimately awarded to it. Specifically, on six negotiated contracts (Nos. DA 20-113-AMC-08522 T, DAA E07-67-C-2225, DA 20-113-AMC-11527 T, DAA E07-67-C-1935, DAA E07-67-C-3112 and DAA E07-67-C-5643) covering 43,774 sprockets delivered during the review years, plaintiff certified that its anticipated margin of profit ranged from 2.46% to 5% of selling price. On the volume involved, the weighted average margin targeted by plaintiff was well under 3.5%. In respect to the cost and pricing figures that it certified to the Government as correct, plaintiff uniformly refused to permit any procurement representatives access to its plant operations when they sought such access in an effort to verify the cost figures that had been submitted to them. Essentially, Mr. Amoe's view was that the Government had no legitimate concern in these matters so long as plaintiff was supplying it high-quality sprockets at prices less than it could otherwise obtain. It appears that during the review years the Government's need for these items was so great and plaintiff had proved itself such a reliable supplier that Mr. Amoe was able to successfully resist disclosure of the full details of his business. In evaluating plaintiff's cost

and pricing submissions for purposes of negotiated awards to it, Government representatives invariably disregarded plaintiff's profit projections and endorsed as fair and equitable a profit margin of 10% on total cost, this in contrast to plaintiff's projections of substantially less than half that much.

25. The evidence adduced by plaintiff affirmatively showed that during the first of the two review years, f.y.e. 6/30/67, it did not realize any economies in production cost that were attributable to manufacturing technology that had not been fully employed throughout the three preceding years. During those three years annual production averaged 17,531 sprockets. When, on cross-examination, Mr. Amoe was asked to explain the drastic rise in profit margin, as a percentage of sales, from f.y.e. 6/30/66 to 6/30/67 he attributed the increase to added volume, pointing out that whereas plaintiff had produced only 17,361 sprockets in f.y.e. 6/30/66, output rose to 53,616 in f.y.e. 6/30/67.

Aside from considerations of volume, the evidence affirmatively suggests one other source of the drastic profit increase experienced in f.y.e. 6/30/67. That source relates to increased selling prices obtained by plaintiff on three of the types of sprockets included in its product line. Mr. Amoe acknowledged that plaintiff had indeed raised prices on the larger sprockets that it supplied the Government. He identified them as bearing ordnance part numbers "691", "597" and "893". The evidence shows that price increases on the quantities of these three types of sprockets delivered during f.y.e. 6/30/67 accounted for additional sales revenue of $295,298.30. It appears that this added revenue, coupled with a reduction in the percentage of sales consumed by general and administrative expenses, as a result of greatly increased sprocket volume, largely explains the increase in pre-tax net profit from $64,377.20 in f.y.e. 6/30/66 to $415,355.83 in f.y.e. 6/30/67.

26. For each of the years indicated, plaintiff's ratio of direct labor cost to sales was as follows:

| | Fiscal year ending June 30, 1964 | | Fiscal year ending June 30, 1965 | | Fiscal year ending June 30, 1966 | |
|---|---|---|---|---|---|---|
| Sales | $604,516.32 | 100% | $879,179.34 | 100% | $949,354.91 | 100% |
| Direct labor | 98,208.00 | 16.2% | 122,969.42 | 13.7% | 132,936.79 | 14.0% |

| | Fiscal year ending June 30, 1967 | | Fiscal year ending June 30, 1968 | |
|---|---|---|---|---|
| Sales | $2,735,328.44 | 100% | $3,749,354.30 | 100% |
| Direct labor | 378,091.71 | 13.8% | 432,323.66 | 11.5% |

**27.** Sprocket volume for the second of the two review years, f.y.e. 6/30/68, was approximately 10% greater than that of the previous one (58,598 v. 53,616). That additional volume served to accentuate the increase in profits resulting from unit cost economies attributable to the two major technological advances that, for the first time, were fully effective in that year; the hooding techniques that quadrupled capacity of the normalizing furnace and the successful adaptation of P&J horizontal turret lathes that yielded a comparable efficiency increase in the counterboring and champfering of sprockets. Finding 11, *supra*. The significant reduction in direct labor cost as a percentage of sales, reflected in the preceding finding, tangibly attests to the production economies that resulted from the greater efficiency brought about by technological advance. In addition, increased volume resulted in a further reduction (to 3.75%) in the percentage of sales revenues consumed by general and administrative expenses.

Finally, the evidence shows that plaintiff's revenues for f.y.e. 6/30/68 were further augmented by more than $676,000, representing increased prices that it obtained for 32,871 type "691", "597" and "893" sprockets that it delivered during that year.

**28.** For purposes of financial comparison with its own operations plaintiff adduced certain statistical materials compiled by Dun and Bradstreet as well as data contained in the Source Book of Statistics of Income, published by the Internal Revenue Service, U.S. Treasury Department. Information contained therein is of negligible probative value for purposes of comparison with the plaintiff because the evidence does not indicate that the entities on which the data are based are functionally comparable to the plaintiff in terms of operations or markets served.

**29.** The evidence is convincing that plaintiff exerted exceptional effort to respond to the Government's critical need for sprockets by taxing its facilities and personnel to the utmost during the two review years. During this entire period plaintiff operated on a three-shift basis, seven days a week. In order to properly oversee that activity Mr. Amoe worked 10–12 hours per day, seven days a week, and Mrs. Amoe regularly worked 8–10 a day, six days a week.

Conclusion of Law

30. Plaintiff's income tax returns for the review years were audited by the Internal Revenue Service and no exception was taken to the salary deductions, including those pertaining to Mr. and Mrs. Amoe, taken on those returns.

31. During each of the review years plaintiff operated in a highly efficient manner. That efficiency reflected itself favorably in plaintiff's costs as against those of other bidders on procurement contracts for the same articles.

32. Plaintiff consistently delivered a high quality product and, considering the volume of product that it turned out, did so punctually.

33. The manufacturing technique required for the production of acceptable sprockets is relatively complex, particularly so with respect to the necessary and proper application of heat treatment.

34. After examination of plaintiff's operations for the fiscal years ended June 30, 1967 and June 30, 1968 the Renegotiation Board determined that its profits for those years were excessive in the respective amounts of $125,000 and $475,000. These figures reflected salary disallowances not made in this proceeding.

## ULTIMATE FINDING OF FACT

The defendant has proved by a preponderance of the evidence that with due regard for efficiency, risk assumption, complexity of manufacturing technique and contribution to the defense effort plaintiff realized excessive profits of $65,000 and $375,000, before allowance for state and federal taxes on income, for the fiscal years ended June 30, 1967 and June 30, 1968, respectively.

## CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the determination herein, the court concludes as a matter of law that plaintiff realized excessive profits of $65,000 and $375,000, before adjustment for state and credit for federal taxes on income, in its fiscal years ended June 30, 1967 and June 30, 1968, respectively. The cause is remanded to the trial division for further proceedings under Rule 131(c).

242-469—78——18

Syllabus

547 F. 2d 548

# EXXON CORPORATION (FORMERLY HUMBLE OIL & REFINING COMPANY) v. THE UNITED STATES

[No. 816-71. Decided December 15, 1976]

ON THE PROOFS

**Taxes; income tax; intangible drilling costs; election to expense or capitalize; pre-installation costs of offshore oil well platforms.**—Plaintiff seeks to recover an alleged overpayment of Federal corporate income taxes and assessed interest for taxable year 1954. The issue is whether certain costs and expenditures incurred by plaintiff in construction of offshore platforms required for the drilling of oil and gas wells in the Gulf of Mexico are subject to the Sec. 263(c) option for "intangible drilling and development costs"; and if so, whether plaintiff is permitted an election either to capitalize or to deduct as expense all "intangible drilling and development costs" as that phrase is defined in Tr. Reg. 118, § 39.23(m)-16. The costs in issue are those incurred for labor, fuel, repairs, supplies and hauling during the land-phase and water-phase construction of offshore platforms (other than platform transportation costs to the wellsite conceded as allowable by defendant) prior to the time that the platform pieces and related materials were lifted by crane from the construction barge. Defendant contends that all expenditures by plaintiff prior to commencement of the water phase, and a portion thereafter, were expenditures by which plaintiff *acquired* property having a salvage value, i.e. the platform and its components, and must be capitalized. It is *held* that the expenditures in question qualify under Sec. 39.23(m)-16 of Tr. Reg. 118 as intangible drilling and development costs and, hence, are subject to the option which plaintiff exercised, and were properly deducted as expense items in its 1954 Federal income tax return. Plaintiff is entitled to recover and judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

**Taxes; income tax; deductions; expenses, trade or business; oil and gas well development; intangible drilling and development costs; election to capitalize or expense.**

[1] The availability of the Sec. 263(c) option of deducting expenditures for intangible drilling and development costs or capitalizing them is not impaired by the fact that the operator contracted out both the land and water phases of the work to an independent contractor.

Internal Revenue ⇐ 567

Syllabus

**Taxes; income tax; deductions; expenses, trade or business; oil and gas well development; intangible drilling and development costs; election to capitalize or expense; legislative intent.**

[2] Congress has consistently viewed the Sec. 263(c) optional treatment of intangible drilling and development costs as an incentive to oil and gas prospecting and exploration, the deduction theoretically reducing or otherwise offsetting the well-known risks of providing capital for such operations. Congress favors a liberal interpretation of implementing Tr. Reg. 118, § 39.23(m)-16.

Internal Revenue ⇐ 567

**Taxes; revenue laws; construction and operation; generally.**

[3] Insofar as the courts are concerned, no weight should be given to the revenue impact of a congressionally-approved tax incentive, such as the oil and gas intangible drilling and development costs option of Sec. 263(c).

Internal Revenue ⇐ 122

**Taxes; income tax; deductions; expenses, trade or business; oil and gas well development; charges to capital v. expenses.**

[4] The oil and gas well intangible drilling and development costs option between deduction and capitalization provided in Sec. 263(c) was intended to and does deviate significantly from the usual rules of capitalization as epitomized by Sec. 263(a).

Internal Revenue ⇐ 567

**Taxes; income tax; deductions; expenses, trade or business; oil and gas well development; intangible drilling and development costs; election to capitalize or expense; pre-installation costs of offshore platforms.**

[5] Pre-installation costs and expenditures for labor, fuel, repairs, hauling, supplies, etc., other than for the construction materials themselves, incurred by an operator in construction of offshore platforms for drilling oil and gas wells are intangible drilling and development costs qualifying for the Sec. 263(c) option, and are not costs of acquiring intangible property having a salvage value. As such, the operator is permitted an election either to capitalize or to deduct such costs pursuant to Tr. Reg. 118, § 39.23(m)-16.

Internal Revenue ⇐ 567

*David W. Richmond*, attorney of record, for plaintiff. *Walter B. Morgan*, *Harold A. Ranzau*, *John J. Hollis*, *Robert L. Moore, II* and *Miller & Chevalier*, of counsel.

*Donald H. Olson*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant.

---

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, DAVIS, SKELTON, KASHIWA, KUNZIG and BENNETT, *Judges*, *en banc*.

PER CURIAM: This case comes before the court on defendant's exceptions, filed April 13, 1976, to the recommended decision of Trial Judge Lloyd Fletcher, filed January 29, 1976, pursuant to Rule 134(h), having been considered on the briefs and oral argument of counsel. Since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the said decision as the basis for its judgment in this case.* It is, therefore, concluded that plaintiff is entitled to recover and judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c).

OPINION OF TRIAL JUDGE

FLETCHER, *Trial Judge:* In this case of first impression, the plaintiff, Exxon Corporation, seeks to recover an alleged overpayment of federal corporate income taxes and assessed interest thereon for the taxable year 1954.[1] The tax return in question reported the operations of Humble Oil and Refining Company (Humble), a predecessor company which has been merged into Exxon, the present owner of the instant claim. The single issue is whether certain costs and expenditures incurred by Humble in the construction of offshore platforms required for the drilling of oil and gas wells in the Gulf of Mexico, are subject to the section 263(c) option for "intangible drilling and development costs." [2] In the event the option was available to Humble, it would be permitted an election either to capitalize or to deduct as expense all "intangible drilling and development costs," as that phrase is defined in Treasury Regulations 118 at § 39.23(m)-16. Availability of the option depends upon classification of the expenditures as intangible drilling and development costs, as so defined, and Exxon asserts that under the precise language of the regulation, Humble's expenditures clearly qualified for the option

*The concurring opinions of Judges Davis, Bennett and Kunzig and the concurring in part and dissenting in part opinion of Judge Kashiwa follow the opinion of the trial judge which has been adopted by the court.

[1] The precise tax period in question is January 1, 1954 through November 11, 1954. The remainder of the calendar year, not here in issue, was reported on a consolidated return.

[2] 26 U.S.C. § 263(c). It has been noted that this option, although long available, was not clearly authorized by statute until the enactment of the Internal Revenue Code of 1954, and that its "history is a curious one, indeed." *Harper Oil Company* v. *United States*, 425 F. 2d 1335, 1338 (10th Cir., 1970).

to expense such costs. The Government argues just as vigorously under the same regulation that the expenditures cannot qualify for the reasons stated by the Internal Revenue Service in its Rev. Rul. 70–596, 1970–2 C.B. 68, and therefore must be treated as capital expenditures subject only to a depreciation allowance.

For the reasons discussed below, it is my opinion that the expenditures in question do qualify under the regulations as "intangible drilling and development costs" and, hence, are subject to the option, which Humble admittedly exercised, and were properly deducted as expense items in its 1954 return.

Most of the facts are undisputed.[3] During 1954 Humble built six templet-type offshore drilling and production platforms,[4] extended one of the six, and also extended one platform which had been built prior to 1954. This platform construction was done for installation on offshore leases in the Gulf of Mexico granted to Humble by the State of Louisiana which leases gave Humble an operating interest in any oil and gas discovered thereon.

The building of these platforms and platform extensions involved several stages. First, they were designed by Humble engineers who prepared detailed plans and specifications from previously furnished information as to water depths, soil, wind, tide, and storm conditions experienced at the well site, coupled with other information as to the desired size of the deck area, weight, and location of drilling equipment, and number and depth of wells to be drilled. Secondly, through competitive bidding, Humble would then engage the services of a marine construction contractor, such as W. Horace Williams Company, whose job was to fabricate on land as much of the platform as was practicable. This land-phase portion

[3] They are here summarized only. The detailed facts are set forth in the Findings of Fact below.

[4] A templet-type platform may be described generally as a large deck area, on which are mounted derricks and various other drilling paraphernalia, all supported above sea level by "templets", which are compound, trussed structures, analogous in function to table legs but composed of several large vertical steel beams and pipes (usually an even number) arranged in a rectangular fashion with bars running between the pipes for support and spacing. Several templets are ordinarily used to support one deck, the number depending on the size, weight, and other features of the deck and equipment to be installed thereon.

of the work was carried out using some materials (usually the heavier steel items) supplied to the contractor by Humble.[5] The remaining items of necessary materials were ordered by the contractor specifically for the Humble project. During the land phase, Humble assigned one or more of its engineers to oversee the progress of the work at the contractor's fabrication yard and assure compliance with Humble's specifications. In addition, a Humble welding inspector was assigned to each job for the purpose of testing the contractor's iron workers (burners, welders, and fitters) for proficiency and inspecting the finished welds on a periodic basis.

Upon completion of the work called for by the land-phase construction contract, the partially constructed platform was loaded on a barge for transport to the drilling site. At this point, the third or so-called "water phase" of the construction began, and it was performed under a separate contract. While in transit, further welding, cutting, and fitting work was performed on the platform pieces, again under the oversight of a Humble engineer and welding inspector, who lived aboard the barge during the water-phase construction. Upon completion of this work, the platform pieces were lifted from the barge, assembled, and anchored to the sea floor by use of a large floating crane. The deck parts were then positioned and the various drilling and other equipment was installed thereon. The termination of the water phase marked the completion of the platform's construction, whereupon it was ready for drilling operations.

Of course, during these three phases of construction, numerous costs were incurred and paid by Humble. For example, during the design phase, Humble utilized its own engineers to design the required platforms and to draft the construction plans and specifications. Other Humble personnel from the Exploration Department were used to determine the most favorable locations for well sites, and, to this end, Humble often employed outside consulting engineers to obtain and furnish information regarding soil conditions in those areas.

[5] The material to be supplied by Humble was recorded on a list furnished to the contractor which designated whether the materials so listed were new or had been salvaged from other platforms.

During the land phase when the initial prefabrications were made, Humble incurred other costs. The land contracts awarded were typical fixed-price contracts which included the cost of labor, materials, fuel, hauling, insurance, and taxes paid by the contractor as well as the contractor's overhead and profit. Also, during the land phase, Humble incurred the costs of transporting the materials which it had agreed to supply to the contractor's yard as well as the costs of assigning a welding inspector and engineer to monitor the contractor's performance. For the water phase, Humble typically awarded cost-plus-fixed-fee contracts because of the hazards and uncertainties incident to construction work at sea. The costs incurred at this stage were similar to those of the land phase covering such items as materials, wages, fuel, barge rentals, floating crane and other equipment rentals, insurance, taxes, meals and lodging during construction at the well site, as well as contractor's profit and overhead. Of these various costs, the ones here in issue are the costs incurred for labor, fuel, repairs, supplies, and hauling during the land-phase construction of offshore platforms, together with the same categories of costs incurred during the water-phase construction of the platforms (other than the cost of transporting the platform parts to the well site which defendant concedes are allowable) prior to the time that the platform pieces and related materials were lifted by crane from the construction barge.

The defendant has conceded that all costs for labor, fuel, repairs, hauling, and supplies incurred by Humble for the installation of the platform after it was lifted from the barge were subject to the option and currently deductible as intangible drilling and development costs. It contends, however, that such costs incurred prior to that time are not subject to the option because they were pre-installation expenditures by which Humble acquired what the regulation calls "tangible property ordinarily considered as having a salvage value."

It is true that Humble would dismantle platforms at locations where no economically productive wells resulted from drilling operations. The dismantling generally occurred in the reverse order of the prior erection and assembly process.

The dismantled platform parts, which were roughly the same prefabricated parts as existed at the completion of the land-phase contract, would then be taken ashore and stored. For the most part, however, Humble's 1954 offshore platforms proved productive and have remained at the well location for production purposes. Hence, as stated above, all of the platforms and platform extensions in issue are still in place in the Gulf with the exception of platform 1428B which was dismantled during 1954 and 1955; most of its parts were reconditioned and used in the construction of another platform.[6]

Humble's rejoinder to defendant's salvage argument is simply that it raises a false and irrelevant issue. Humble points out that it always capitalized, and never expensed, the costs of the actual materials used in constructing the platforms, such as pipe, beams, and similar materials which are the only salvable items. The costs which it expensed were for items such as labor, fuel, etc., which in themselves do not have a salvage value and hence are clearly intangible drilling and development costs.

Since both parties agree that the resolution of this dispute requires an interpretation of Reg. 118, § 39.23(m)–16, the starting point must be a quotation of the exact text of the regulation insofar as pertinent here. The pertinent parts thereof are as follows:

> (a) Items chargeable to capital or to expense at taxpayer's option:
>
> (1) Option with respect to intangible drilling and development costs incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) in the development of oil and gas properties: All expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary

[6] In addition to salvaging such materials as it could, Humble had other reasons for dismantling and removing unproductive platforms instead of simply leaving them in the water. Since Humble knew it could be directed by the Army District to remove a platform upon expiration of its permit in order to reduce navigational hazards posed by the platform, it elected to do so as soon as the platform ceased to be useful. Humble also recognized that by removing an unproductive platform as soon as possible and even prior to expiration of the permit, it could thereby avoid the substantial costs of maintaining navigational aids as required by the United States Coast Guard. Humble's exposure to liability for damages resulting from possible ship collisions with the structures was also reduced by early dismantling.

for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account. Such expenditures have for convenience been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work (excluding amounts payable only out of production or the gross proceeds from production, and amounts properly allocable to cost of depreciable property) done for them by contractors under any form of contract, including turnkey contracts. Examples of items to which this option applies are, all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used (i) in the drilling, shooting, and cleaning of wells; (ii) in such clearing of ground, draining, road making, surveying, and geological works as are necessary in preparation for the drilling of wells; and (iii) in the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas. In general, this option applies only to expenditures for those drilling and developing items which in themselves do not have a salvage value. For the purpose of this option, labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value.

* * * * *

(b) Recovery of optional items, if capitalized:

* * * * *

(2) Items returnable through depreciation: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depreciation insofar as they are represented by physical property. Such expenditures are amounts paid for wages, fuel, repairs, hauling, supplies, etc., used in the installation of casing and equipment and in the construction on the property of derricks and other physical structures.

* * * * *

(c) Nonoptional items distinguished:

(1) Capital items: The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value.

> Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation.
>
> * * * * *

"Intangible drilling and development costs" (hereinafter IDC) is a phrase peculiar to the law of oil and gas taxation and, in the words of the above regulation, is used only "for convenience." [7] It describes all expenditures made for "wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas * * *" The regulation allows an "operator" the option of deducting such expenditures from gross income as expenses or charging them to capital account.

Since the parties do not dispute that Humble was an "operator" entitled to make such election, that the offshore platforms are "physical structures," that they are "necessary for the drilling of wells and the preparation of wells for the production of oil or gas," and that the election was properly made, the controversy centers solely on whether the expenditures in question were for "labor, fuel, repairs, hauling, and supplies * * * used * * * in the construction" of offshore platforms, within the meaning of the regulation.[8]

Singularly enough, both parties rely solely on the language of the regulation in formulating their positions, and the result has been aptly described by defendant as "the pervasive semantical differences which exist in this case." Tracking the language of the regulation, plaintiff argues that all construction costs (including land costs) for items which in and of themselves have no salvage value (*e.g.*, labor, fuel, etc.)

---

[7] The use of such shorthand descriptions is, of course, a well-known technique in tax law. Consider, for example, such phrases as "spin-off," "collapsible corporation," "ABC transaction," "Clifford trust," and many others, all unique to taxation with no common law significance.

[8] It is undisputed that the availability of the option is not impaired by the fact that Humble contracted out both the land and water phases of the work to an independent contractor.

qualify as IDC, and emphasizes that the regulation specifically provides that "in general, this option applies only to expenditures for * * * items which in themselves do not have a salvage value" and that "for the purpose of this option, labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value." It also points to the provision that "the option * * * does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value * * * [such as] the actual materials in [the] structures," and reiterates that in accordance with this latter excerpt, it has always capitalized the cost of such items as the steel pipes, beams, and other "actual materials" used in the construction of the platforms.

The defendant interprets the regulation differently but likewise directly from its wording. In the Government's view the examples given of items within and without the option create three major categories of construction-type costs, all of which do not qualify as IDC. First, there is the category of expenditures which are "used * * * in the construction of physical structures * * * which in themselves do not have a salvage value." These admittedly qualify as IDC. There is then a second category comprised of expenditures for labor, fuel, etc. "by which the taxpayer *acquires* tangible property ordinarily considered as having a salvage value." (Emphasis added.) These *acquisition* expenditures, in the Government's view, do not qualify for the option. Finally, there is a third category of expenditures for labor, fuel, etc. "used in connection with the installation of physical property which has a salvage value," and these are qualified IDC.

It is in this last category that the Government has placed a considerable portion of the water-phase costs and allowed them to be deducted as IDC. However, the Government argues that all expenditures by Humble prior to the commencement of the water phase, and a portion thereafter, were expenditures by which Humble *acquired* property having a salvage value, *i.e.*, the platform and its components. This classification of all land expenditures and a portion of the water-phase expenditures as *acquisition* costs is crucial to

the Government's position that these costs must be capitalized. In my opinion, that position is untenable.

At the outset, it may be instructive to note briefly the history of the IDC option. Although it has been available to oil and gas operators since 1917, it did not originate from any specific statutory provision but rather from Treasury Department action in the form of regulations. Despite this somewhat unusual genesis, no serious attack on the validity of the option was made. But in 1945, the Fifth Circuit Court of Appeals severely restricted the coverage of the regulation to the consternation of the oil industry. *F. H. E. Oil Co.* v. *Commissioner*, 147 F. 2d 1002, rehearing denied in 149 F. 2d 238 and again in 150 F. 2d 857 (5th Cir., 1945). This decision seemingly prompted the adoption by Congress of Concurrent Resolution 50, 79th Cong., 1st Sess., 59 Stat. 844 (1945) reading in its entirety as follows:

> *Resolved by the House of Representatives* (*the Senate concurring*), That in the public interest the Congress hereby declares that by the reenactment, in the various revenue Acts beginning with the Revenue Act of 1918, of the provisions of section 23 of the Internal Revenue Code and of the corresponding sections of prior revenue Acts allowing a deduction for ordinary and necessary business expenses, and by the enactment of the provisions of section 711(b)(1) of the Internal Revenue Code relating to the deduction for intangible drilling and development costs in the case of oil and gas wells, the Congress has recognized and approved the provisions of section 29.23 (m)–16 of Treasury Regulations 111 and the corresponding provisions of prior Treasury Regulations granting the option to deduct as expenses such intangible drilling and development costs.
>
> Passed July 21, 1945.

Congress did not thereafter revisit the IDC option until 1954 when a new Internal Revenue Code was under consideration. At that time there was added to what became the Internal Revenue Code of 1954 a new provision designated Section 263 (c) reading as follows:

> (c) *Intangible drilling and development costs in the case of oil and gas wells.*—Notwithstanding subsection (a), regulations shall be prescribed by the Secretary or his delegate under this subtitle corresponding to the

> regulations which granted the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells and which were recognized and approved by the Congress in House Concurrent Resolution 50, Seventy-ninth Congress. 26 U.S.C. § 263(c).[9]

From this statutory and administrative history of the IDC option, Circuit Judge (now Mr. Justice) Blackmun, speaking for a unanimous court in *Harper Oil Company* v. *United States* was able to conclude at 425 F. 2d 1335, 1342 (10th Cir. 1970):

> The option, although long possessed of dubious statutory ancestry, now has firm congressional authority in § 263(c) of the 1954 Code.

This brief account of the option's history has been stated as a prelude to the conclusion that Congress has consistently

[9] There is very little in the legislative history of the 1954 Code with respect to reasons for enactment of new § 263(c). The House Ways and Means Committee report (H. Rep. No. 1337 83d Cong. 2d Sess.) says nothing at all. The Senate Report notes that the House bill made no changes in prior law and that the Senate Finance Committee "has added an amendment to make it clear that the provisions of the bill do not affect the treatment now allowed by regulations [*i.e.* Reg. 118, § 39.23(m)–16] relating to the deduction or capitalization of intangible drilling and development costs in the case of oil and gas." S. Rep. No. 1662, 83d Cong., 2d Sess. p. 81 (1954). Likewise the hearings before both Committees disclose nothing particularly helpful in interpreting the regulations.

The predecessor and successor regulations to the one here in question are almost identical and little is to be gained from a comparison of the several versions. *Compare* Reg. 111, § 29.23(m)–16 (1943) with Reg. 118, § 39.23 (m)–16 (1951) and with Reg. §§ 1.263(c)–1 and 1.612–4 (1965).

Those commentators who have specifically addressed the question of offshore platform IDC are in disagreement among themselves. See, for example, Breeding, Burke & Burton, *Income Taxation of Natural Resources*, § 14.12 (1972) (offshore platform IDC not deductible); Baum, *Intangible Drilling and Development Costs: Some Recurring Problems*, 21st Inst. on Oil & Gas L. Tax. 337, 344 (1970) (IDC deductible); Klayman, *The New Intangible Drilling and Development Regulations and Their Implications*, 25 N.Y.U. Tax Inst. 99, 101 (1967) (IDC partially deductible); Andersen & Co., *Oil and Gas Federal Income Tax Manual* (8th ed.) (1960) pp. 328–9 (IDC deductible). In 1969, Miller noted the absence of court decisions and published rulings on offshore platform IDC, although in the 1974 edition of his book he reported the issuance of Rev. Rul. 70–596, the correctness of which is presently in issue. Miller, *Oil & Gas Federal Income Taxation* § 20–32 (1969 and 1974).

For general discussions of IDC in their various ramifications, see also Bennion, *Intangible Drilling and Development Costs: The Final Regulations*, 15 Tul. Tax Inst. 665 (1965); Fiske, *Federal Taxation of Oil and Gas*, 5 Oil & Gas Tax Q. 83 (1956); Fielder, *The Option to Deduct Intangible Drilling and Development Costs*, 33 Tex L. Rev. 825 (1955); Miller, *The Intangible Drilling Deduction*, 100 J. Acc. 40 (Sept. 1955); Jackson, *Tax Planning Before Drilling: The Operator's Problem*, 27 Tul. L. Rev. 21 (1952); Judge, *Problems of the Oil and Gas Industry: Federal Income Tax Problems*, 9 N.Y.U. Tax Inst. 453 (1951); and Mahin, *Deduction for Intangibles*, 2d Inst. on Oil & Gas Tax L. 367 (1951).

viewed the optional treatment of IDC as an incentive to oil and gas prospecting and exploration, clearly a continuing objective of national importance.[10] It follows that Congress favors a liberal interpretation of the regulation. For example, in the House Report accompanying Concurrent Resolution 50, *supra*, it is stated that the "uncertainty occasioned by raising doubts as to the validity of these regulations is materially interfering with the exploration for and production of oil." H.R. Rep. No. 761, 79th Cong., 1st Sess., p. 2 (1945). Similar concerns were expressed during floor debates on the resolution. 91 Cong. Rec. 7801–12, 8967–70 and 7891–93 (1945).[11]

These background observations show that the courts should not be niggardly in their approach to Reg. 118, § 39.23(m)–16. Otherwise, there is always the danger of becoming far too busy with the trees to see the forest. Equally important, however, is the realization that dealing with some of the "chameleon-hued words"[12] of the regulation is a perilous venture during which care must be taken not to extend the obvious benefits of the IDC option beyond its intended boundaries, whether inadvertently or by verbal ingenuity. And, insofar as the courts are concerned, at least, no weight should be given to the revenue impact of a Congressionally-approved tax incentive such as the IDC option.[13]

---

[10] By providing an immediate "write-off" of expenditures normally capitalized and amortized over a period of time, the deduction theoretically reduces or otherwise offsets the well-known risks of providing capital for oil and gas exploration. See, generally, Jackson, *Tax Planning Before Drilling: The Operator's Problem*, 27 Tul. L. Rev. 21 (1952) (concluding that, on the average, 60 percent or more of the costs of a producing well are IDC, and that the deduction is allowed to induce the risking of such capital). See, also, Murray, *Intangible Drilling and Development Costs of Oil and Gas Wells*, 26 Taxes 312, 316 (1948) (stating that a major purpose of the option privilege is to provide an offset to the "considerable risks involved in drilling").

[11] In passing, it may be noted that when an opportunity arose to undercut or abolish the drilling incentives provided by the option, Congress did not do so. See 1939 Code, § 711(b)(1)(I), of the now repealed Excess Profits Tax of 1940. By providing therein that IDC deductions would be disallowed only if "abnormal" or otherwise excessive for the previous four years, Congress appears to have affirmed its policy of encouraging the risking of capital in drilling operations.

[12] See Hohfeld, *Fundamental Legal Conceptions*, p. 35 (1923).

[13] The estimated revenue loss attributable to expensing IDC in the Budget for F.Y. 1968 was $300,000,000. In the Budget for F.Y. 1976 the estimate had increased to $1,365,000,000. For an erudite discussion of the policy of using tax incentives to achieve non-tax goals, see Surrey, *Tax Incentives as a Device for Implementing Government Policy*, 83 Harv. L. Rev. 705 (1970).

Keeping in mind the rather cordial attitude demonstrated by Congress towards the IDC option, I now turn to the specific words of the regulation as they apply to the costs of constructing an offshore platform. The costs generally incurred by an oil and gas operator (such as Humble) in such construction fall into several broad categories. They are the costs of the actual materials used in the structure, labor necessary to construct the same, transportation thereof, and miscellaneous costs such as repair work, fuel, supplies, and the like. Of these several categories, the regulation clearly provides that the "costs of the actual materials in those structures" may not be expensed but must be capitalized and depreciated.[14] Reg. § 39.23(m)–16(c)(1). With equal clarity, however, the regulation grants an option to the operator with respect to all other of the categories listed above. The very first sentence of § 39.23(m)–16(a)(1) states:

> All expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account.

The regulation then goes on to place two conditions on the optional expensing of these cost items, namely, (1) they must have been incurred "in the construction of such derricks, tanks, pipelines and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of oil or gas," and (2) they must not in and of themselves "have a salvage value."

The record in this case shows that, from time to time, plaintiff has recovered some materials from salvaged platforms which it reconditioned and used in other platforms. This fact is immaterial, however, because the regulation also makes it clear that of the several costs enumerated above:

> * * * labor, fuel, repairs, hauling, supplies, etc., *are not considered as having a salvage value*, even though used in connection with the installation of physical property which has a salvage value. [Emphasis supplied.]

[14] As previously noted, Humble did not expense such costs but charged them to capital account.

Since it is agreed on both sides that the only costs in issue here are wages for labor, fuel, repairs, hauling, supplies, and the like, all of which were "incident to and necessary for the drilling of wells" at sea, and since the listed expenditures in themselves do not have a salvage value, it would seem that the "bottom line" has been reached and the matter is at an end.

But not so, says the defendant. Pointing to the use of the word "installation" in the sentence of the regulation last quoted above, defendant concludes that the scope of the IDC option has been specifically limited so that only those expenditures incurred in the course of installing the constructed property at the well site are deductible. This interpretation excludes from the option all expenditures made in the construction of physical property at a place other than the well site no matter how necessary such pre-installation construction may have been to the drilling and preparation of the well. Such emasculation of a long-standing regulation, recognized and approved by Congress in § 263(c), *supra*, simply cannot be sustained.[15]

In seizing upon this isolated word "installation" as controlling the entire operation of the regulation, defendant has grossly misread its own language. The obvious reason for the clause in question is to eliminate a possible contention that the option-type expenditures (labor, fuel, etc.) acquire a salvage value simply because they were connected with the installation of admittedly salvable property. Thus, as plaintiff correctly observes, the clause in no way restricts the application of the regulation but instead expands it to include a situation where option-type expenditures can be related to salvable property without losing their own characterization as nonsalvable items.

In the process of advancing its impoverished interpretation, the defendant quite naturally has attempted to present it in respectable attire. Citing such authoritative decisions as *Commissioner* v. *Idaho Power Co.*, 418 U.S. 1 (1974) and *Southern Natural Gas Co.* v. *United States*, 188 Ct. Cl. 302,

[15] The Treasury's issuance of a regulation followed on by a later refusal to apply it where to do so would result in the collection of less revenue has been referred to by a respected commentator as "bizarre administrative behavior." Eisenstein, *A Critical View of the Treasury*, 15 N.Y.U. Inst. on Fed. Tax 21, 30 (1956).

412 F. 2d 1222 (1969), defendant says there can be no question that labor, fuel, repairs, hauling, and supplies used in the construction of physical structures "are to be treated as part of the cost of acquisition of a capital asset." *Idaho Power Co.*, *supra*, at p. 13. Hence, they "should be included in the asset's depreciation base, to be recovered over the life of the asset." *Southern Natural Gas Co.*, *supra*, at 188 Ct. Cl. 373, 412 F. 2d 1265.

Reliance on these cases for such a well-established rule of tax law illustrates the poverty of defendant's argument and reveals to what extent it would mutilate the specific exception to the general rule as spelled out in Reg. 118, § 39.23(m)–16. Those cases involved Code § 263(a) (or a predecessor section) providing that "no deduction shall be allowed for * * * any amount paid out for new buildings * * * or betterments made to increase the value of any property * * *" In contrast, § 263(c), which adopted by reference the long-standing IDC option to deduct or capitalize such costs, is an *express* exception to § 263(a) and provides a choice between deduction and capitalization "notwithstanding subsection (a)." Neither section 263(c), nor the implementing regulation, was involved in the cited cases. Apparently, defendant simply refuses to recognize that the IDC deduction was intended to and does deviate significantly from the usual rules of capitalization as epitomized by § 263(a).

Next, defendant rather surprisingly relies on the decision in *Harper Oil Co.*, *supra*. The dispute there was over whether "surface casing," which is steel pipe installed in the well to prevent water contamination and surface caving, qualified for the IDC option. The taxpayer argued that such casing did qualify because it was cemented into the ground, could not be removed under Oklahoma law, and thus had no salvage value. The Tenth Circuit disagreed and held that the cost of casing, specifically described by subsection (c) of the regulation as a nonoptional item, remained such even though under the particular circumstances the casing could not, in fact, be salvaged. Plaintiff, of course, finds no fault with this decision since it has never contended that any of its costs specifically described by the regulation as nonoptional items (such as "actual materials" or "casing") can qualify for the

option simply because some of them may be nonsalvable. To the contrary, plaintiff instead understandably relies on the clear distinction made by the *Harper Oil* decision itself as follows at 425 F. 2d 1342:

> * * * One might expect an expenditure for tangible hard goods, such as surface-casing, or any casing for that matter, not ordinarily to qualify as an "intangible" drilling or development cost. *Standing in contrast, and qualifying, would be an appropriate labor or services cost.* [Emphasis supplied.]

Defendant's final point with respect to its salvage argument is that an offshore drilling platform becomes completely salvaged at the instant of an oil or gas "strike" which has the effect of converting the structure from a drilling facility to a production facility. While it is true that by the express terms of the regulation the IDC option is available only for the enumerated costs incurred during the "drilling" and "preparation" stages, it is a monstrous step to the defendant's conclusion that "total salvage" of the entire facility occurs at the moment the oil string of casing reaches the oil trap in the producing sands. This would mean, of course, that *no* costs relating to a platform are deductible because they *all* have salvage value as part of a production facility. Yet, inconsistently with its argument, defendant concedes that hauling and installation costs are optional expenditures. Therefore, to accept such an argument would only "lead to possible inconsistencies and certainly to taxpayer and administrative confusion." *Harper Oil Co.*, *supra*, at 1343.

In addition, as plaintiff cogently points out, the argument is directly contrary to Treas. Reg. § 1.167(a)–1(c) (and predecessor authorities) which provides that salvage occurs only "upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer." Clearly, plaintiff's further utilization of platforms in the production of oil and gas is totally incompatible with the platforms being "retired from service" and "no longer useful in the taxpayer's business."

In a supplemental brief, defendant argues that plaintiff's reference to a provision dealing solely with depreciation is misleading. This accusation stems from defendant's contention that the words "salvage value" when used in a provision dealing with computation of basis for depreciation mean something entirely different from those same words as they appear in the IDC regulation because there they are used in their "abstract sense." This Alice-in-Wonderland approach cannot be accepted.[16] Defendant says it is "critical to an understanding of the subject Regulation to appreciate that it applies only to qualifying expenses incurred in the drilling phase of the oil and gas business." Df's Supp. Br., p. 3. No one disputes the validity of this statement just as no one disputes the proposition that the actual materials used in the construction of an offshore platform have salvage value. However, it is necessary to repeat, perhaps *ad nauseam*, that plaintiff did not deduct the costs incurred for such items.

If, by the statement quoted above, defendant means to infer that the only deductible expenditures are those incurred during the "drilling phase" at the well site itself, then defendant is plainly wrong. In this connection, defendant has stated at pp. 22–23 of its main brief:

> * * * The costs of fabricating derricks, which were purchased by the taxpayer in a prefabricated state as "a derrick", have never been considered as being allowed by the Regulations, and the taxpayer does not suggest otherwise.

In fact, however, plaintiff does "suggest otherwise." It vigorously, and correctly, attacks defendant's statement as "unsupported," and points to those provisions of the regulation which clearly state that the regulation covers optional expenses incurred by "contractors under any form of contract" and which specifically give as examples of deductible costs those "amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them which are used * * * in the construction of such derricks * * * as are necessary for the drilling of wells and the preparation of wells for the production of

[16] "When I use a word," Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean—neither more nor less." Carroll, *Through the Looking Glass*, Dial Press Ed., p. 238.

oil or gas." Accordingly, plaintiff properly concludes that, when an operator who has elected the option contracts for a derrick to be built to specification, it has no choice but to deduct on a current basis those costs attributable to the contractor's expenditures for labor, fuel, supplies, hauling and repairs. In like manner, when a platform is built under contract for an operator who has elected the option, as in this case, those same costs must be deducted currently under the regulation.

In sum, then, it must be concluded that the restrictive interpretation given to Reg. 118, § 39.23(m)–16 by the Government as reflected in Rev. Rul. 70–596, *supra*,[17] and elaborated upon in its briefs herein should be disapproved. By the expedient of a stingy reading, one should not frustrate the obvious Congressional purpose to encourage oil and gas prospecting, for to do so would be the most emphatic type of judicial legislation. The fragmentation of the regulation inherent in the Government's interpretation can only result in the proliferation of ambiguities, overlaps, and problems of categorization, to say nothing of leading to that "taxpayer and administrative confusion" decried by Mr. Justice Blackmun in *Harper Oil*. It is far preferable and more consistent with the regulation's purpose to interpret it as setting forth a simple and basic rule that optional intangible drilling and development costs are those expenditures by an oil and gas operator for items which are incident to and necessary for the drilling of wells *and* which, when each is considered individually as a unit in and of itself, have no salvage value.

Hence, Exxon is entitled to recover. The record indicates no dispute as to the amount of costs at issue, but to the extent disagreement should arise, determination of the exact amount of recovery will be made in further proceedings as contemplated by Rule 131(c).

---

DAVIS, *Judge*, concurring:

Although I do not find the result in this case to be absolutely clear, I agree with Trial Judge Fletcher's conclusion

[17] We are reminded in the "Introduction" to each issue of the Internal Revenue Bulletin that the Revenue Rulings published therein "do not have the force and effect of Treasury Department Regulations * * *"

and, in general, with his basic reasoning. Certainly the opening bars of the regulation present a broad all-embracing theme wholly in harmony with the taxpayer's claim that it has the option to charge off as expenses *all* intangible drilling and development costs incurred in the development of its offshore oil and gas properties. It is only the later interpolation of the "salvage value" motif which allows the Government to argue that the costs now in question add salvage value to tangible items (*e.g.* templets) and must therefore be depreciated as part of those capital assets. But the more natural and less strained reading of the regulation—in view of its over-all structure; the dominant placement of the main theme and the later introduction of the "salvage value" concept in subordinate and contrasting fashion; the precise words used with respect to the idea of "salvage value"—seems to me to attach "salvage value" only to physical and tangible materials and to exclude it entirely from those expensible items which the regulation designates as "intangible drilling and development costs" (*i.e.* amounts paid for labor, fuel, repairs, hauling, supplies, etc.) even though those intangible items may be expended in connection with templets or other such tangible fabricated property. In other words, the regulation, in its references to "salvage value," contrasts the intangible costs as to which the taxpayer has the option with the costs of the physical materials as to which he does not. The "salvage value" references simply contrast and define the other side of the coin. They do not have the affirmative function (as defendant would have it) of carving out of the regulation's broad opening (and all-embracing) provisions certain types of intangible drilling and development costs which cannot be expensed. The purpose of the "salvage value" sentences is, rather, to contrast the drilling and development items which are not intangible costs of any kind, but which "in themselves" have salvage value because they directly involve tangible materials.

Defendant emphasizes the term "installation" in one sentence [18] as showing that intangible costs are to be covered

[18] "For the purpose of this option, labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value."

by the option only if they can add nothing to salvage value; installation costs, it is said, fall into that category because they have to be reversed when the property is salvaged, while intangible fabrication costs continue to form part of salvage value. But this explanation proves too much even from defendant's own viewpoint. Hauling expenditures and much of the cost of fuel (both expressly designated by the regulation as intangible costs) can add no salvage value to fabricated products, and yet defendant insists on their exclusion from coverage. The preferable interpretation of the sentence seems to me that given by the trial judge—to eliminate a possible contention that the option-type intangible expenditures acquire a salvage value simply because they are connected with the installation of admittedly salvageable tangible property.

Similarly, the other sentence on which the Government mainly relies [19] was not meant, as I see it, to limit or restrict the broad reach of the opening part of the regulation but, instead, to point out, by way of comparison and contrast, those tangible drilling and development costs which are not open to optional treatment. The very next sentence tells us what are these non-covered expenditures-for-tangibles: "Examples of such items are the costs of the *actual materials* in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc." (emphasis added). This sentence does not exclude the whole cost of the structures—including the intangible costs involved in the construction of the structures—but only "the costs of the *actual materials* in those structures" (emphasis added).

Perhaps the regulation, which was formulated before offshore drilling was foreseen, is too all-embracing for current conditions. Perhaps it should be narrowed as defendant wishes. If so, the proper method is by prospective amendment of the regulation or by legislation, not by an attempt

[19] "The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value."

to read the regulation in a drastic new way,[20] inconsistent with its long-standing terms and format, as well as contrary to its natural meaning.

---

BENNETT, *Judge*, concurring:

While I agree with Trial Judge Fletcher's result and join in the concurring opinion of Judge Davis, I believe a further comment is in order. A strong reason, not elsewhere articulated, for interpreting the regulation as the trial judge and plaintiff would have us read it is that their interpretation is workable. Defendant's reading of the regulation, on the other hand, would present substantial difficulties in the administration of the tax laws. The court should not strain to reach an interpretation, not clearly compelled, that would have such a result. *Commissioner* v. *Brown*, 380 U.S. 563, 571 (1965); *Steuer* v. *United States*, 207 Ct. Cl. 282, 294 (1975); *Kantor* v. *United States*, 205 Ct. Cl. 1, 6 (1974). There is considerable appeal in defendant's view of the regulation, for the theory that it ascribes to the regulation's accounting scheme is familiar: one-time expenditures for items that contribute to the construction of platform components with continuing value should be capitalized and depreciated, rather than expensed. If, however, certain otherwise intangible drilling costs are to be capitalized, according to defendant's theory, it would become necessary to determine exactly what components of the final assembly could be saved as they are and subsequently reused. This would not be an easy exercise.

The trial judge pointed out that each platform in the present case was designed to accommodate ocean depth and current conditions at the proposed drilling site. This immediately leads one to suspect that platform component subassemblies are not uniformly salvable. In this case, one platform was dismantled and its parts stored in roughly their state of assembly at the completion of the land-phase construction stage. Does this warrant the conclusion that all platform

[20] So far as we have been informed, there is no indication of any IRS practice, prior to the emergence of the off-shore problem, of excluding from optional coverage any intangible drilling and development costs connected with the fabrication or construction of land-based derricks or other drilling equipment.

components, or all of plaintiff's forerunner's 1954 platform components, are salvable in the same state of assembly? Is the entitlement to current deductions or the requirement of capitalization under the regulation to be determined in each case on the basis of a plaintiff's salvage history? What would be the plight of a future plaintiff who could point to no instances of salvage, so successful were his geologists' predictions? Defendant's argument that a taxpayer would be required to capitalize the intangible costs of building those components "ordinarily" possessed of continuing value, tracking the language of subsection (c) (1) of the regulation and the reasoning of *Harper Oil Co.* v. *United States*, 425 F. 2d 1335 (10th Cir. 1970), while perhaps removing the subjective element from the determination, would not make its rule any easier to apply. The focus of the questions may shift: What is the "ordinary" state of assembly in which a component of a tailor-made platform remains after the platform is dismantled? To ascertain the ordinary salvage value of a component, is one to consult industrywide history or practice of salvage, or expert opinion regarding what would have been reusable? Despite the difficulty of the questions and the imprecision that would necessarily result from resort to estimation, the drilling operator's accountants and the IRS's auditors would be expected, under defendant's approach, to come up with answers on salvage value in exact figures, and to do so in the year of the platform's construction, not in the year of its razing.

Were we to follow defendant's reading of the regulation, the accounting for each platform would potentially revolve about fact problems not at all readily resolved or resolvable. Considering the number of platforms built (with changing technology) by a variety of drilling operators since 1954, and yet to be built, the problem takes on staggering proportions. For the added reason that defendant's interpretation of the regulation would be altogether cumbersome in application for the taxpayer, the IRS, and for the courts when the first two cannot agree, the court does well to avoid that interpretation and to stand by the reading that it adopts.

Judge Kashiwa, Concurring and Dissenting in Part

KUNZIG, *Judge:*

I concur in the per curiam opinion of the court and further express my general agreement with the separate views stated by Judges Davis and Bennett.

---

KASHIWA, *Judge*, concurring in part and dissenting in part:

In this case of offshore drilling operations, the majority of the court by affirming and adopting the trial judge's recommended decision allows as intangible drilling and development costs ("IDC") those costs incurred in fabricating offshore drilling platforms ("platforms"), moving them to location and making them operational. I, however, would allow only the latter two groups of expenditures to qualify for the IDC option, denying the option to those costs incurred in fabricating the component parts (e.g., templets)[21] of the drilling platform.

With relation to the IDC problem before us, I believe that the goal is to determine which costs are attributable to an item having a salvage value and which costs are attributable to wages, fuel, repairs, hauling and supplies incurred in using that item for the drilling of wells or their preparation for production.[22] It seems clear that the costs of moving the platform from the shore to the place where it will be used for drilling and of securing it so that it can be so used qualify as IDC. On the other hand, a strong argument can be made that the cost of fabricating the component parts of the platform does not fall within the option on the ground that the component parts are items having a salvage value.

Each 1954 platform was individually designed for a specific location to take account of the peculiarities of that location; however, the basic concept and design was a templet-

[21] For ease in discussion throughout this opinion, I will refer only to templets as the pre-fabricated basic component parts of the drilling platform. However, there were other pre-fabricated basic component parts, such as cap and portal sections. To the extent that the other basic component parts are similar to the above discussed templet sections, I would deny the IDC option to the costs incurred in fabricating those component parts.

[22] The costs to which I refer, in addition to the enumerated costs, include the cost of insurance and taxes, as well as the contractor's overhead and profit.

type offshore platform.[23] The design differences among platforms and platform extensions at different locations included the number of templets utilized to provide horizontal support for the platform pilings and the size of the deck areas.[24] However, the basic component, the templet unit, was standard for all platforms.[25] This basic templet unit came only in two sizes, 10′ x 10′ and 20′ x 20′.[26] Despite the size difference, the templet unit was designed, fabricated, installed, salvaged, repaired and stored as a basic unit. The unit never reverted back to its original state, viz., "such as lengths of pipe and steel beams." [27]

The fabrication process was the manner by which Humble acquired the templet unit. During the fabrication process of this basic templet unit, labor, fuel and supplies were integrated with tangible basic materials to form an item. The item, a basic templet unit, was designed to be salvaged.[28] When salvaged the labor, fuel and supplies that went into its fabrication were also salvaged. As a result, the costs attributable to wages, fuel and supplies incurred during the fabrication of this templet unit should not qualify for the IDC option because they were "expenditures by which the

---

[23] All platforms built or extended by Humble (plaintiff's predecessor) in 1954 were templet-type platforms. Findings of Fact, No. 8. Therefore, this opinion does not consider with respect to the IDC option the other types of offshore structures used by oil companies in 1954, such as caissons and jacket-type platforms.

[24] For other design differences, see Findings of Fact, No. 7.

[25] Templets are fabricated structures composed of steel beams and pipe which are designed to support the platform deck.

[26] A well-documented pictorial treatise, "Humble Oil and Refining Company, Civil Engineering Project Report, July 20, 1956," Joint Exhibit 1, in evidence and part of the record of this case, visually presents the construction of a Humble offshore drilling platform.

[27] See Findings of Fact, No. 4.

[28] On October 29, 1954, Humble wrote to Williams requesting a bid for the dismantling and salvaging for reuse of a platform, stating in part: "* * * In dismantling the platform, the material should be removed as nearly as possible in sections and shapes that can be reused in future construction and should be handled in such manner as to prevent damage to the sections. *Contractor will be expected to remove the templets intact* and to pull the piling and anchor piles from the Gulf bottom." [Emphasis supplied.] Williams was awarded the salvage job contract. Attached thereto was an exhibit titled "Specifications for Salvage of Offshore Platforms" reading, in part, as follows:

"The platform shall be *dismantled in sections or parts corresponding to the prefabricated sections or parts* from which the platform was erected. * * *

* * * * *

*"Templet sections, cap and portal sections and other fabricated sections shall be stocked as units.* * * *" [Emphasis supplied.] [Findings of Fact, No. 23.]

taxpayer * * * [acquired] tangible property ordinarily considered as having a salvage value." Treas. Reg. 118, § 39.23(m)–16(c)(1). Those costs, therefore, are recoverable only through depreciation.

The fact that dismantling and salvaging of platforms was a difficult operation and that during the salvage operation parts of the platform were badly damaged while other parts were not salvaged at all does not affect the IDC option. In the words of Justice Blackmun:

> The salvage value reference [29] [Reg. § 1.612–4(c)(1) (1965)] strikes us only as the usual, but not the necessary, characteristic of the non-option item. We do not regard salvage value as a condition of non-option status. [Footnote supplied.] [*Harper Oil Co.* v. *United States*, 425 F. 2d 1335, 1342 (10th Cir. 1970).]

Since the templets were designed to be salvaged as a component part in unit form, they ordinarily would be considered as having a salvage value without regard to the frequency of actual salvage or the actual reasons therefor. Nevertheless, as the trial judge found, "after considerable modification and reconditioning, most of the salvaged parts of [the platform] * * * were reusable at least once in other platforms." [30] The extent of modification to which the trial judge refers is the joining together of several 10′ x 10′ templets in order to form a 10′ x 20′ templet, or the adding of extensions to the basic templet unit.[31] The basic unit design of the templet was never altered. As a result, the labor, fuel and supplies utilized to fabricate the lengths of pipe and steel beams into a templet were permanently integrated into the templet, and thereby had salvage value.[32]

---

[29] Although Justice Blackmun was referring to Treas. Reg. § 1.612–4(c)(1) (1965), that identical language appears in Reg. 111 § 29.23(m)–16(c)(1) issued under the 1939 Code and applicable to the instant case.

[30] Findings of Fact, No. 24.

[31] Findings of Fact, No. 25.

[32] An item not in issue in the present case but still analogous to the basic templet unit is the component parts of the derricks which were used on the 1954 platforms.

The derricks were constructed for Humble by contractors. Rolled steel shapes, such as angles, channels and beams, as well as steel grating, bolts and washers, were used in fabrication of derricks. These basic materials were fabricated into derrick parts by cutting the pieces to length, punching them for bolt holes and galvanizing them. The parts thus fabricated and compris-

(Continued)

After having carefully read the trial judge's recommended decision and before entering into further discussion, I note the focal emphasis in the trial judge's opinion is not on the basic templet component unit as above described but, rather, is on the tangible basic materials which make up the templet unit. In my opinion, the trial judge incorrectly assumes that the intangible basic materials (labor, fuel and supplies) utilized to fabricate the tangible basic materials (steel beams and pipes) into a templet unit do not have a salvage value. I view the costs attributable to labor, fuel and supplies, etc., incurred by the taxpayer in fabricating the basic templet unit as expenditures by which the taxpayer acquired "tangible property [the templet unit] ordinarily considered as having a salvage value." Reg. 118, § 39.23(m)–16(c)(1). Therefore, those expenditures are nonoptional items.

I do not feel that a complete reading of the pertinent Regulations, in light of their history, provides support for the trial judge's decision within the intent of the drafters of the Regulations.

The IDC option first saw light in T.D. 2447, relating to the Revenue Act of 1916, and read as follows:

> The *incidental expenses* of drilling wells, that is, such expenses as are paid for wages, fuel, repairs, etc., *which do not necessarily enter into and form a part of the capital invested or property account*, may, at the option of the individual or corporation owning and operating the property, be charged to property account subject to depreciation or be deducted from gross income as an operating expense. [Emphasis supplied.]

The Treasury language was a cautious venture into the field, granting the option in guarded terms. The option was similarly stated, though in more detail, in the regulations

---

(Continued)
ing the part required for a complete derrick were purchased by Humble from the supplying firm as a dismantled derrick. These parts were then erected into a derrick on the platform by a rig building contractor. When the derrick was no longer required on the platform, due to cessation of drilling operations, it was dismantled, transported to another platform and re-erected. (Findings of Fact, No. 27).

As with the basic templet unit, those costs incurred in moving, assembling and making the derrick parts operational as a derrick would in a proper case be allowed to qualify for the IDC option. The expenditures for wages, fuel and supplies, etc., incurred in fabricating the basic tangible materials into derrick parts would not qualify for the IDC option.

promulgated under the Revenue Acts of 1916, 1917, 1918, 1921, 1924 and 1926.

In 1932, Treasury Decision 4333 [33] restated the provisions of all prior regulations relating to intangible drilling and development costs. The restated regulations,[34] said to make "no change in administrative policy or in the practice under the regulations," [35] more clearly described the IDC option. The pertinent provisions of Reg. 118, here in issue, remain virtually unchanged in form as carried forward from T.D. 4333.[36]

In 1945 Congress passed Concurrent Resolution 50,[37] approving the existing and prior regulations relating to the option. With the adoption of the 1954 Code, in Section 263(c) Congress did no more than direct the Treasury to prescribe regulations corresponding to the regulations which were approved by Congress in Concurrent Resolution 50.

This brief account of the history of the IDC option is important with respect to an interpretation of Reg. 118 provisions here in issue.

The drafters of the regulations, as above shown, have consistently demonstrated an intent to qualify for the IDC option those costs which are "incidental expenses," costs which do not "enter into and form a part of the capital invested or property account," and costs "which in themselves do not have a salvage vlue." In other words, expenditures by which the taxpayer does not require "tangible property ordinarily considered as having a salvage value" have been the recurring theme to determine qualification of expenditures for the IDC option.

The relevant provisions, as applied to the instant case, of Treas. Reg. 118, construed in light of the drafters' apparent overall goal, set forth the task to determine which costs are

[33] T.D. 4333, XI–1 Cum. Bull. 31 (1932).

[34] Treas. Reg. 103, § 19.23(m)–16.

[35] T. D. 4333, *supra* at 31.

[36] It should be noted that in 1943 the Treasury issued T.D. 5276 (1943 Cum. Bull. 151, amending Treas. Reg. 103) which constituted a complete overhaul of the IDC option for taxable years beginning after December 31, 1942. Except for the fact that costs subject to the IDC option were defined to include the cost to the operator of any drilling or development work done for him by contractors under any form of contract, T.D. 5276 did not change with respect to the instant case any pertinent provision of T.D. 4333, which carried over to Reg. 118.

[37] H.R. Con. Res. 50, 79th Cong., 1st Sess. (1945); 1945 Cum. Bull. 545.

attributable to an item having a salvage value and which costs are incurred in using that item for the drilling of wells or their preparation for production. As previously analyzed, the items of expense incurred in fabricating the salvageable component parts of the platform structure did add value to the basic tangible materials which in part comprised the component unit and that value can be salvaged when the overall structure is dismantled and the components reused. On the other hand, the items of expense incurred in assembling the component parts to form a section, in moving the section to the drilling site and in securing it so that it can be used for the drilling of wells qualify for the IDC option. This latter group of costs are labeled in the regulations as hauling and installation costs.

Although the trial judge acknowledges that the basic component units of the platform do have a salvage value,[38] he interprets the regulations to restrict the application of the "salvage value" phrase so as to have that phrase relate only to the tangible raw materials from which the templets and other basic components were fabricated. Recognizing that subsection (c)(1) of the IDC regulations gives "examples" of items to which the option does not apply, the trial judge focuses on the fact that the taxpayer does not seek to deduct the cost of the "actual materials" used in the offshore platforms. Nevertheless, because under the taxpayer's practice the basic templet unit and other component parts of the platform are salvaged as a unit, the costs incurred in fabricating those component units have salvage value. The example which refers to the "actual materials" used in the offshore platforms within the sense of the regulation, in my opinion, includes the fabricated templet basic unit components. Those are the relevant "actual materials" from which the offshore platforms were constructed.

To buttress his conclusion that the costs incurred during fabrication of the basic component units do not have salvage value and thereby qualify for the IDC option, the trial judge quotes from the *Harper Oil* decision.[39] The trial judge emphasizes the last sentence of the above-mentioned quote, implying that *Harper Oil* supports his reasoning. To my

[38] At page 271.
[39] At page 274.

understanding, the above referred to sentence lends support for this dissenting opinion rather than for the majority opinion. Justice Blackmun was directing comment to the labor, fuel and supply costs incurred in installing the casing, not to the labor, fuel and supply costs incurred in fabricating or manufacturing the casing. This observation becomes clear when one reads the entire paragraph from which the quoted passage is taken. By paraphrasing Mertens Law of Federal Income Taxation and by referring to the "cost of * * * casing," Justice Blackmun clarifies his prior statement whereby he was referring to installation costs, not manufacture costs, of the casing. Juxtapose Justice Blackmun's discussion concerning casing with my previous discussion concerning templet units. The result is that the cost of installing templet units, viz., assembling the units to form structural legs of the platform, would qualify for the IDC option; however, the cost of fabricating the basic templet units would not qualify for the IDC option.

The trial judge also placed great reliance upon the sentence in the regulations which reads:

> For the purpose of this option, labor, fuel, repairs, hauling, supplies, etc., are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value.

The trial judge correctly reasons that:

> * * * [t]he obvious reason for the clause in question is to eliminate a possible contention that the option-type expenditures (labor, fuel, etc.) acquire a salvage value because they were connected with the installation of admittedly salvable property. * * * [T]he clause in no way restricts the application of the regulation but instead expands it to include a situation where option-type expenditures can be related to salvable property without losing their own characterization as nonsalvable items. [At page 272.]

However, by focusing on the tangible basic materials instead of the salvageable basic component units of the platform, the trial judge, in my opinion, incorrectly concludes that Humble installed "lengths of pipe and steel beams." On the contrary, Humble installed the basic component unit. Consistent with

the regulations, installation costs of the basic component unit are subject to the option; the only costs not subject to the option are those costs incurred in fabricating the platform components. It is those costs which I contend have a salvage value.

In order to support his conclusion that the above-quoted regulation sentence brings fabrication as well as installation costs within the IDC option, the trial judge reasons that the drafters intended the word "installation" to expand the coverage of the IDC option to include "option-type expenditures [which] can be related to salvable property without losing their own characterization as nonsalvable items." Consistent with the trial judge's reasoning, the quoted sentence "expands" the coverage of the regulation only insofar as it assures that the immediately preceding regulation sentence [40] is not to be interpreted to disallow installation costs incurred with respect to salvageable property.

Another critical inquiry in this case is the proper meaning to be attributed to the words "in themselves." [41] In addressing the problem of interpreting this phrase, the trial judge chose to substitute the phrases "in and of themselves" (at page 271) and "in and of itself" (at page 276) for the actual words of the regulation. In my opinion the trial judge gave undue emphasis to the words "in themselves" and thereby failed to acknowledge the importance of subsequent language in the regulation which bears on the inquiry.

In at least three separate places in the Regulations in issue, installation costs are singled out for favorable treatment. Thus, the Regulations distinguish between those costs incurred in the installation of physical property and those costs incurred in acquiring the tangible items being installed. The labor, fuel, etc., used in erecting the platform structure, or in transporting the structure to the drilling site, add no value to the structure which can be salvaged when the drilling operation is completed and, hence, do not "in themselves" have salvage value. On the other hand, labor, fuel, etc., used in fabricating the salvageable components of such a structure

[40] "In general, this option applies only to expenditures for those drilling and developing items which in themselves do not have a salvage value." Reg. 118, § 39.23(m)–16(a)(1).

[41] See note 40.

do add value to and become integrated with the tangible basic materials comprising the component part. Therefore, the items, both intangible and tangible materials, have salvage value "in themselves." Having a salvage value "in themselves," the items do not qualify for the IDC option; the cost of the items must be capitalized and recovered only through depreciation. In other words, the general rule as stated in Section 263(a) of the Internal Revenue Code of 1954 is applicable, not the exception to the general rule, i.e., Section 263(c).

It should be noted that the IDC option remains, as it has been since its birth, an addendum to the general capitalization principle enunciated by § 263(a). *Harper Oil*, *supra* at 1342. Capitalization of this kind of cost is the rule and expensing the exception. The deduction afforded by § 263(c) is not a matter of right; rather, it is a matter of legislative grace. The deduction must be authorized by "clear provision." And it is the taxpayer who has the burden of demonstrating that he is entitled to the deduction. *Harper Oil*, *supra* at 1342; *New Colonial Ice Co.* v. *Helvering*, 292 U.S. 435, 440 (1934); *Deputy* v. *duPont*, 308 U.S. 488, 493 (1940); *United States* v. *Olympic Radio & Television, Inc.*, 349 U.S. 232, 235 (1955); *New World Life Ins. Co.* v. *United States*, 88 Ct. Cl. 405, 26 F. Supp. 444 (1939); *Mayer* v. *United States*, 126 Ct. Cl. 1, 111 F. Supp. 251 (1953). In my opinion, the taxpayer in the instant case has failed to demonstrate by pointing to a clear provision in the regulations that it is entitled to deduct *via* the IDC option those costs incurred while fabricating the basic component units of its drilling platform. For the foregoing reasons, I am firmly convinced that the costs of fabricating the basic templet units, a necessary component part in the templet-type platform used by Humble during the tax years in question, are not subject to the IDC option.

FINDINGS OF FACT

**1.** The plaintiff, Exxon Corporation (Exxon), is a Delaware corporation engaged in substantially all phases of the petroleum and petrochemical businesses, including exploration, development, production, refining, transportation, and marketing.

On November 12, 1954, Standard Oil Company (New Jersey) acquired in excess of 80 percent of the voting power of all classes of stock of Humble Oil & Refining Company, a Texas corporation, hereinafter referred to as Humble. Humble timely filed a separate income tax return for that portion of 1954 (January 1, 1954 through November 11, 1954) during which its income was not included in the consolidated return filed by Standard Oil Company (New Jersey). On December 1, 1959, Humble entered into an agreement with Humble Oil & Refining Company, a Delaware corporation hereinafter referred to as Humble (Delaware), whereby Humble transferred all of its assets to Humble (Delaware) and Humble (Delaware) assumed all the obligations and liabilities of Humble. The name of Standard Oil Company (New Jersey) was changed to Exxon Corporation and on January 1, 1973, Humble (Delaware) was merged into Exxon Corporation, which thereupon became the owner of the claim here in issue.

2. During 1954, Humble built in the Gulf of Mexico offshore oil drilling and production platforms. These offshore platforms were numbered by Humble 797E, 797F, 798D, 804G, 820E, and 1428B. An extension was added to platform 820E later in 1954. Also extended in 1954 was a seventh platform, number 802C, which had been built prior to 1954. These platforms were located on numbered leases which leases conveyed to Humble an operating interest in the territory subject thereto.[42]

3. These offshore platforms and extensions thereof were necessary for drilling wells in the seabed and thereafter preparing the drilled wells for the production of oil and gas. The platform extensions were built to permit the drilling of wells in excess of the number for which the platform had originally been designed. Whenever a well drilled from an offshore platform proved productive, the platform remained at the location of the well and was thereafter used for production purposes. All of the platforms and platform extensions mentioned above with the exception of platform 1428B,

[42] Platforms derived their identification numbers from the number of the particular state lease upon which the platform was located. For example, platform 798D was located on land subject to lease number 798. The "D" indicates that 798D was the fourth platform erected on lease 798.

are still in place in the Gulf of Mexico and are being used as production units. Platform 1428B was dismantled during 1954 and removed from the Gulf in 1955.

**4.** The amounts in issue, which Humble deducted on its 1954 Federal income tax return pursuant to an election to deduct all "intangible drilling and development costs", are the costs incurred by Humble for wages, fuel, repairs, hauling, and supplies during the land-phase and water-phase construction of these platforms and platform extensions. However, a portion of the construction costs incurred by Humble (for wages, fuel, repairs, hauling, and supplies) in building offshore platforms are not in issue; the defendant does not contest that Humble properly deducted as intangible drilling and development costs all of its water-phase construction costs incurred after the partially constructed parts of a platform, and related materials, were lifted by crane from the construction barge. These latter construction costs were classified by the examining agent as currently deductible "erection" costs, in contrast to the earlier construction costs classified by the agent as non-deductible "fabrication" costs. Accordingly, the water-phase construction costs in issue are the costs incurred before the platform pieces and related materials were lifted by crane. The costs of the actual materials in the platforms, such as lengths of pipe and steel beams, were not deducted by Humble on its 1954 Federal income tax return and, accordingly, are not in issue. The dollar amounts of expenditures in issue per platform are as follows:

| *Platform* | *Land Phase* | *Water Phase* | *Total* |
|---|---|---|---|
| 797E | $64,886 | $26,689 | $91,575 |
| 797F | 43,158 | 20,855 | 64,013 |
| 798D | 117,836 | 30,168 | 148,004 |
| 802C Ext | 31,564 | 14,416 | 45,980 |
| 804G | 61,948 | 22,262 | 84,210 |
| 820E and 820E Ext | 90,104 | 42,903 | 133,007 |
| 1428B | 110,691 | 48,403 | 159,094 |
| Total | $520,187 | $205,696 | $725,883 |

**5.** Humble's Exploration Department selected the drilling site for each of the offshore platforms. Information as to each selected site location was transmitted to Humble engineers in its Operations Division which was charged with

the responsibility of designing the platforms. These engineers then gathered further pertinent information about the particular drilling site under study such as water depth, tides, wind and storm ratings, wave forces, soil conditions, number of wells to be drilled, depth of wells, type and weight of the drilling rig, and location of rig components and supporting facilities on the deck. Some of this information, particularly underwater conditions, was obtained by the Operations Division from outside consulting engineers who performed core drillings and furnished soil surveys. Other information, such as the anticipated number of wells to be drilled at each location, the type of drilling rig to be used, and the nature of the supporting facilities to be placed on the platform, was conveyed to the Humble engineers by the Operations Division superintendent.

**6.** Thereafter Humble engineers prepared all detailed plans and specifications for each platform or platform extension to be constructed. In the course of these preparations, there was correspondence among Humble engineers in the Headquarters Production Department located in Houston, Texas, Humble engineers in the Louisiana Division Office located in New Orleans, Louisiana, and Humble engineers in the Humble District Office located at Grand Isle, Louisiana. In 1954 the basic design work was performed in Houston by the Office of the Chief Civil Engineer in the Headquarters Production Department. The actual plans, construction specifications, and construction drawings were prepared by the Louisiana Division Office in New Orleans, but any design changes or modifications proposed by the Louisiana Division Office were reviewed and either approved or disapproved by the Headquarters Production Department in Houston.

**7.** Each platform in 1954 was individually designed specifically to take account of various factors pertinent to the particular site location. See finding 5, *supra*. Recognition of these factors, which varied from one site location to another, necessitated some design differences between platforms at different locations. Examples of the differences actually occurring among the 1954 platforms and platform extensions include (a) the number of templets which provided hori-

zontal support for the platform pilings, and which ranged from four to nine per platform, (b) the sizes of the templets which were 10′ x 10′ for some platforms, and 20′ x 20′ for others, (c) the templet spacings, (d) the deck areas, ranging from 70′ x 85′ to 60′ x 120′, (e) the type and size of structural pilings, (f) the sizes and weights of cap beams and types of portal bracing (both used to connect the templets to each other), sizes and weights of skid beams, of templet legs and bracing, of deck beams and of conductor pipe and (g) the weights of the platforms which ranged from 466 tons to 1,000 tons.

8. Although the 1954 platforms were designed for a specific location and to take account of the peculiarities of that location, the basic concept and design of a templet-type offshore platform in 1954 had been standardized. The original concept was developed by W. Horace Williams Company, Inc. (hereinafter "Williams"), and in 1947, through the joint efforts of Humble and Williams personnel, Humble erected the first operational templet-type platform in the Gulf of Mexico. There were other types of offshore structures used by oil companies in 1954 such as caissons and jacket type platforms. Caissons are large, installed single pipes, used for purposes other than drilling. Jacket-type platforms utilize a single-trussed structure (rather than several trussed structures, such as templet-type platforms) for vertical support and are suitable mainly for use in shallow water. All platforms built or extended by Humble in 1954 were templet-type platforms.

9. The platform construction process was divided into two stages referred to as the "land phase" and the "water phase." Humble did not employ its own personnel to perform either the land phase or water phase construction, because it was uneconomical to maintain a continuing labor force for these purposes. Therefore, Humble engaged independent contractors to perform the actual construction of its platforms.

10. Humble selected its independent construction contractors by writing to various construction companies requesting bids. Such invitations for bids were generally sent to Williams, to J. Ray McDermott Company of Assumption Parish, Louisiana, and to Brown & Root, Inc. of Plaquemines

Parish, Louisiana. All three were well-known, experienced marine contractors. In addition, invitations to bid were sent to Hunt Tool Company for platforms 797E and 797F and to Young-Elkins Machine & Supply Company for platform 797F.

Attached to the invitations were the plans and specifications for the platform involved which had been prepared by Humble engineers, as above described. Also attached were sample contracts and a list of materials to be supplied by Humble. Generally, this Humble-supplied material consisted of structural goods such as the heavier steel beams and larger sizes of pipe. The list of material further indicated whether the material furnished by Humble was new or second class (salvaged).

**11.** Upon receipt of an invitation to bid, Williams' personnel estimated the costs which would be incurred in performing both the land and water phase contracts. Williams then submitted its bids to Humble, whose engineers analyzed the elements of the cost estimates for each bid. The analysis would set forth for each land phase contract the costs of materials to be furnished by Humble and of those to be furnished by Williams, the costs of performing the land phase prefabrication work on the platform components, the costs of loading the platform components onto barges for transportation to the offshore site, and the amount of the contractor's overhead and profit. Included in the analysis of the land phase estimate for costs of performing the land phase prefabrication would be a detailing of costs for labor, fuel, repairs, supplies, and hauling incurred by the contractor. These detailed costs would reflect both direct and indirect costs. An analysis would also be made for each water phase contract on a similar basis. The water phase analysis would set forth a breakdown of direct and indirect costs for materials, transportation, labor, insurance, and the contractor's fee.

**12.** It was customary for separate contracts to be entered into for the land and water phases of each platform or platform extension. The land phase contract was typically a fixed-price contract while the water phase contract was a cost-plus-fixed-fee contract. A cost-plus-fixed-fee contract

was used for the water phase because uncertain weather conditions in the Gulf made it difficult to estimate the total costs involved.

With the exception of one platform, Williams was awarded the land and water contracts for all platforms and platform extensions built during 1954. Hunt Tool Company was awarded the land contract for platform 797F.

13. A typical land phase contract in 1954 contained the following language:

> Contractor agrees to begin immediately and to press with due diligence until completion in a good and workmanlike manner with the necessary plant facilities, supervision, crews, tools, machinery and equipment furnished and maintained by Contractor at his own cost and expense the erection, fabrication or construction of the parts in accordance with the plans and specifications agreed to by Contractor and Humble, of one (1) marine type offshore drilling structure with spud piles * * * for use at a well location known as Grade Isle * * * on (the) Gulf of Mexico. It is the intention of the parties hereto that Contractor shall, under this contract, prefabricate as much of the platform and shall perform as much of the actual work towards the building of said platform as may be possible and consistent with good engineering practice towards the end that the least amount of work for the erection of this platform will remain to be done under the Water Phase of the job which is covered by a separate contract. When completed, Contractor agrees to load all of the parts of such structure into barges furnished by Contractor at Contractor's terminal and to make same ready for transportation to the well location.
>
> The specifications, * * * and the plans * * * according to which the Contractor is to fabricate and construct such parts are attached hereto and made a part hereof for all purposes * * *
>
> * * * * * *
>
> Humble has in stock and will make available to Contractor at New Orleans, Louisiana, certain material, templets, structural steel and steel pipe. From this material it has been agreed between the parties that Contractor shall employ the items and the quantities which are specified in Material Inventory List attached hereto.
>
> * * * * * *

Upon notice from Contractor to Humble that all of the structural parts have been completed in accordance with the terms and requirements of this contract, the acceptance thereof by Humble and the loading thereof by Contractor upon its barges ready for transportation to the well site, the contract price shall be due and payable by Humble to Contractor.

**14.** Upon being awarded a land phase contract, Williams would order the materials which it was obligated to furnish under the contract, and Humble would furnish the materials which it had agreed to furnish.[43] When the materials ordered by Williams for a Humble platform arrived at Williams' construction or fabrication yard, they were identified on the shipping documents as pertaining to a particular platform job, although each piece was not itself specifically so marked. Although legal title to such materials did not pass to Humble until delivery of the platform parts to the transportation barge, Williams regarded the materials as "belonging" to Humble, since it had purchased them specifically for the purpose of satisfying its contractual obligations to Humble.

**15.** After the platform construction materials had been assembled in Williams' fabrication yard, approximately fifty Williams' employees, mostly iron workers, were deployed in the performance of the land phase contract. The iron workers were classified into three basic groups according to skills; namely, burners, fitters, and welders. A burner, using an acetylene torch, cut the steel beams, pipe, bars, and plate into the required shapes and sizes required by Humble specifications. A fitter, taking the pre-cut pieces, further trimmed and fitted the pieces together in order that they might then be welded. The welders first tack-welded the fitted pieces and then returned to perform the finish welds.

**16.** Before a welder could perform work on any of Humble's 1954 platforms, he had to pass a test administered in the contractor's yard by a Humble welding inspector from the Louisiana Division Office in New Orleans, Louisiana.

[43] In 1954, a Humble offshore drilling and production platform was constructed from several principal categories of materials, including (a) rolled structural steel shapes known as "H" beams, (b) structural steel pipe, (c) structural steel bars and plate, and (d) structural timber. Humble purchased and supplied the heavier materials, such as steel beams and plate from steel mills, and Williams obtained and supplied the smaller items which it also purchased from steel mills.

Williams did not test the welders whom it hired to perform work on a Humble platform, but instead relied upon Humble's welding inspector to determine whether the welders were qualified to do the work. After testing the contractor's welders, the Humble welding inspector periodically checked the welds which were made during the course of the land-phase construction to determine if the welding was being performed in accordance with Humble's plans and specifications. In the event a weld was found to be defective, the welding inspector required Williams to replace it. In addition to a welding inspector, a Humble engineer from the Louisiana Division Office inspected the progress of the land construction work during visits from time to time to the contractor's yard. Both he and the welding inspector could, and in some cases did, require Williams to revise its work to conform to Humble's plans and specifications. Williams assumed no responsibility for the adequacy or performance of the platforms which it constructed from Humble's plans and specifications.

**17.** It was agreed as a term of the land job contract that Williams would perform as much of the prefabrication and construction work on land as was reasonably possible. Therefore, Williams generally carried out its land-phase construction work to the point where the platform was in the largest pieces that could be lifted by crane onto the barge. However, an additional limiting factor with respect to land-phase construction was the size of the canal from Williams' yard to the Gulf of Mexico, since the platform could only be constructed on land to the extent that it could pass under the bridges over the canal as well as through the canal locks.

**18.** When the various component parts of the platform in their largest manageable size had been completely loaded onto the barge, or barges, the land phase of the construction contract was at an end. The water stage of construction began with the towing of the barges to the drilling site in the Gulf of Mexico. The construction work on the water was performed from a construction ship or construction barge which had a crane capable of lifting the pieces of the partially constructed platform. A substantial amount of welding, cutting, and fitting work was performed on the construction

barge before pieces of the platform were lifted by crane. The welding, cutting, and fitting work performed after the platform pieces were lifted by crane is not in issue because the defendant has conceded that these construction costs are currently deductible as intangible drilling and development costs.

**19.** During the water work, Humble assigned a civil engineer and a welding inspector to the project who ascertained whether the work conformed to the standards and specification set forth in the water-phase contract. The engineer and the welding inspector held the same authority during the water work as the division engineer and welding inspector held during the land work. The engineer and welding inspector often lived on the construction vessel throughout the the water stage.

**20.** If no economically productive wells were drilled at a particular location, the platform would be dismantled. The dismantling generally occurred in the reverse order of the prior erection and assembly process. The dismantled platform parts, which were roughly the same prefabricated parts as existed at the completion of the land-phase contract, would then be taken ashore. There they would be stored at Humble's Grand Isle installation or in a contractor's yard for further disposition.

For the most part, however, Humble's 1954 offshore platforms proved productive and have remained at the well locations for production purposes. Hence, as stated above, all of the platforms and platform extensions in issue are still in place in the Gulf with the exception of platform 1428B which was dismantled during 1954 and 1955.

**21.** There were several reasons for dismantling and removing unproductive platforms instead of simply leaving them in the water. The construction permits from the Army District Engineer required Humble to remove a platform upon expiration of its permit, or if the platform was incomplete at the expiration of the permit, or upon request. Since Humble knew it would probably be directed to remove a platform upon expiration of its permit in order to reduce navigational hazards posed by the platform, it elected to do so as soon as the platform ceased to be useful. Humble

also recognized that by removing an unproductive platform as soon as possible and even prior to expiration of the permit (which was often valid for as long as ten years), it could thereby avoid the substantial costs of maintaining navigational aids such as lights, horns, and bells on the platform, as required by the United States Coast Guard. Humble's exposure to liability for damages resulting from possible ship collisions with the structures was also reduced by early dismantling. Finally, Humble was able to use the components of the dismantled platforms in the construction of other drilling and production platforms. For example, platform 1428B, which proved unproductive, was dismantled in late 1954 and early 1955, and most of its parts were thereafter reconditioned and used in a platform built on state lease 2729.

22. With respect to the monetary value and economic feasibility of reusing salvaged materials, there are Humble files containing estimated figures which suggest that the costs of salvage operations consistently exceeded the monetary value of the materials expected to be salvaged, all as indicated by what management called an Authorization for Expenditure (AFE).[44] The actual cost of salvage, however often varied from the estimated cost thereof as Humble's actual experience with the removal of about sixteen platforms shows. Sometimes the actual cost would exceed the estimated cost by as much as 40 percent, and sometimes the reverse occurred. Sometimes a similar type of variance could be noted between the actual and the estimated values of salvaged parts. Accordingly, at this stage of technological experience in offshore platform construction, such estimates appeared to be little more than engineer guesses.

On one occasion, the dismantling of platform 1428B in 1954, the salvaged components were valuable to Humble as a means of expediting the construction of another platform, without regard to any particular monetary value they might have had. Humble had dismantled that particular platform with the intent of immediately reusing the components and thus hasten the construction of the platform on lease 2729

[44] An AFE was a device used by Humble management formally and officially to authorize the commencement of a planned project. In the context of value, it represented the estimated value of the parts after salvage, as calculated prior to the commencement of the salvage operation.

without losing the time otherwise required to fabricate the components from new steel.

**23.** On October 29, 1954, Humble wrote to Williams requesting a bid for the dismantling and salvage for reuse of platform 1428B, stating in part:

> You are invited to submit a bid to cover the salvage of this platform. The work to be done consists of: (1) removing all parts of the platform and eight anchor piles from the Gulf; (2) loading this salvaged material on barges; (3) transporting salvaged material to Contractor's yard; (4) unloading all salvaged material; (5) reconditioning all material by removing all marine growth, mud, rust scales and damaged protective coatings by adequate hand and/or mechanical methods, and priming all exposed steel; and (6) storing for use in other platforms. In dismantling the platform, the material should be removed as nearly as possible in sections and shapes that can be reused in future construction, and should be handled in such manner as to prevent damage to the sections. Contractor will be expected to remove templets intact and to pull the piling and anchor piles from the Gulf bottom.

Williams was awarded the Salvage Job contract which was signed on November 24, 1954. Attached thereto was an exhibit titled "Specifications for Salvage of Offshore Platforms" reading, in part as follows:

> The platform shall be dismantled in sections or parts corresponding to the prefabricated sections or parts from which the platform was erected. Where the handling of larger parts will materially speed the work in the Gulf, parts commensurate with the capacity of the equipment being used may be removed. Such parts, however, shall not destroy the integrity of the prefabricated sections and shall be further dismantled in Contractor's yard for conditioning and storage. All sections or parts shall be rigged for handling in such manner as to prevent damage to the sections or parts in loading and unloading.
>
> * * * * *
>
> After being unloaded in Contractor's yard or other yard specified by Humble, all parts, sections and materials from the dismantled platform shall be conditioned for storage and/or use in future platforms by removing all marine growth, mud, rust scales and damaged protective coatings by adequate hand and/or mechanical

methods and by priming all exposed steel to prevent further corrosion while stored. * * *

* * * * *

Templet sections, cap and portal sections and other fabricated sections shall be stocked as units. Beams, piles and pipe shall be marked to show length of each piece, with fade-proof crayon, so as to be readable after stocking without handling other pieces. Creosote decking may be used for cribbing and shall be placed so beams and pipe will drain and bear evenly. Small items such as bolts, lag screws, fence posts, floor flanges, clevises, etc., shall be grouped for inventory and storing. All junk items shall be assembled in one pile for disposition by Humble.

**24.** The dismantling and salvage of platform 1428B was a difficult operation, and parts of the platform were badly damaged in the process. One principal cause for this was the use by the contractor of an 80-ton crane, the capacity of which proved insufficient to pull the templets from the Gulf floor according to plan. As a result, dynamiting was resorted to for loosening the templets, and the explosive blasts caused substantial damage to some platform parts.[45] Nevertheless, after considerable modification and reconditioning, most of the salvaged parts of platform 1428B were reusable at least once in other platforms. Some parts were not immediately reused, but were reconditioned and stored in Williams' yard for future reuse. Other salvaged parts were junked or sold as scrap, such as conductor pipe, pile caps, and severely damaged portions of templet legs or braces, of fence, of walkway, of cellar, and of stairway. Parts of platform 1428B not salvaged at all included the anchor piles, the "H" piling, and several lower templets.

**25.** The platform erected on state lease 2729, in the construction of which significant parts of platform 1428B were used, was located on a site with conditions quite different than those where platform 1428B had been located. The soil foundation in the South Pass area (state lease 2729) was considerably different than that in the Grand Isle area (state

[45] In later platform salvage operations, Humble managed to avoid some of the difficulties and damage which occurred during the salvage of platform 1428B. For example, J. Ray McDermott Co., Inc. used a 250-ton American crane to pull the templets of platform 929B.

lease 1428). The South Pass area is geologically newer than the Grand Isle area, and its soil foundation, being composed of soft, highly unstable muds, is less competent than that at Grand Isle. As a result, the platform pilings penetrated an average of 420 feet into the muds and were the deepest piles driven by Humble at that time for platform purposes. The nine templets, salvaged from platform 1428B and reused at South Pass, each required 35 foot extensions to adapt them to this reuse. In addition, the near surface conditions at South Pass differed from those at Grand Isle and necessitated radical changes to provide a greater capacity of the platform to resist the lateral load from wave forces. To increase lateral stability and provide additional support under the drilling rig, several 10′ x 10′ templets from platform 1428B were remodeled into three 10′ x 20′ templets for use on the seaward side of the South Pass platform.

26. Occasionally Humble would design, or actually begin prefabrication of, a platform before the exact site had been established. At such times, the approximate location of the site was known, and the platform would be designated for accounting purposes as a "stock platform". In this manner, expenses and other tabulations could be appropriated, accumulated, and identified to the proper platform, and work begun without waiting for designation of the exact site. Usually this method was used only when the contemplated site was close to a lease line. Only minor design modifications were required when the exact site location was eventually determined, which was usually never more than several hundred feet from the approximate location.

27. Derricks, such as those used on the 1954 platforms, were constructed for Humble by contractors. Rolled steel shapes, such as angles, channels and beams, as well as steel grating, bolts, and washers, were used in the fabrication of derricks. These basic materials were purchased by a supplying firm. The supplying firm then fabricated these basic materials into derrick parts by cutting the pieces to length, punching them for bolt holes and galvanizing them. The parts thus fabricated and comprising the parts required for a complete derrick were purchased by Humble from the supplying firm as a derrick (dismantled). The principal

supplying firms were Lee C. Moore and Emsco Derrick and Equipment Company. The derricks and derrick substructures supported the drilling rig equipment. The derricks were constructed on the platforms by a rig building contractor. "Construction" really consisted of "erection", since no substantial fabrication occurred at the platform site. As noted above, the supplying firms from whom Humble purchased the derricks had already performed the fabrication work prior to the erection phase on the platforms. When a derrick was no longer required on a platform, due to cessation of drilling operations, it was dismantled, transported to another platform, and re-erected in the same manner. It was normal practice to utilize a drilling derrick on more than one drilling platform if drilling schedules so permitted. The construction work performed on derricks consisted of transportation, labor, and equipment required to erect the derrick on the drilling platform. In the case where a drilling derrick was dismantled, moved, and re-erected on another drilling platform, it was then necessary to replace bolts and bent or missing members, as well as damaged flooring. Derricks were transported in a "knocked-down" condition, since they were too bulky and fragile to transport in an erected condition.

28. With respect to the administrative proceedings herein, the parties have stipulated that on March 3, 1965, the Commissioner of Internal Revenue assessed a deficiency in income taxes against Humble with respect to its income tax return filed for the period January 1, 1954, through November 11, 1954. A portion of that deficiency, in the amount of $349,726, was due to the disallowance of deductions claimed for offshore platform construction expenditures attributable to the tax period totaling $791,172. Humble paid the deficiency plus assessed interest, and thereafter timely filed its claim for refund in the amount of $558,733, representing the $349,726 portion of the deficiency plus $209,007 assessed interest. On November 17, 1967, the Internal Revenue Service issued a notice disallowing the claim for refund of Humble under Section 6532(a)(1) of the Internal Revenue Code. Following agreements extending the time for bringing suit until November 16, 1971, Humble timely filed its petition herein on November 12, 1971.

**29.** Subsequent to the filing of the petition, defendant's counsel requested that the revenue agent examine the amounts set forth in the petition, and with the concurrence of Humble, he reduced the amount in controversy regarding the water work on platform 797E, in the amount of $7,011, and also reduced the land costs and water costs on platform 802C, in the amounts of $250 and $57,750, respectively. The plaintiff concedes that these amounts were not currently deductible because they related to production operations rather than drilling operations. It was determined by Humble that platform 797J was actually erected in 1955 and the controverted expenditures relating to that platform, in the amount of $67,276, were actually deducted on the 1955 return. Accordingly, the plaintiff is entitled to a refund for 1954 in the amount of the deficiency and assessed interest attributable to platform 797J. After making these adjustments, the amounts remaining in issue with respect to the several platforms are set forth in tabular form above. See finding 4.

**30.** The amounts of tax and assessed interest in issue are also stipulated by the parties as follows:

| | |
|---|---|
| Platform expenditures in issue | $725,883 |
| Less applicable to joint owners | 67,000 |
| Total disallowed | 658,883 |
| Less increase in depreciation due to disallowance | 9,884 |
| Net amount disallowed | 648,999 |
| Prorated amount of net disallowance attributable to short-period return (1-1-54 to 11-11-54) | 560,095 |
| Tax (at 52% rate) on $560,095 net disallowance | 291,249 |
| Assessed interest attributable to tax on prorated net disallowance | 174,059 |
| Total tax and assessed interest attributable to prorated amount of net disallowance | 465,308 |

## CONCLUSION OF LAW

Upon the foregoing findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment is entered to that effect, with the determination of the exact

Syllabus

amount of recovery to be made in further proceedings under Rule 131(c).

---

In accordance with the opinion of the court, a memorandum report of the trial judge and a stipulation of the parties, it was ordered on February 4, 1977 that judgment for the plaintiff be entered for $512,818, together with statutory interest as provided by law.

---

546 F. 2d 886

## SIMMONDS PRECISION PRODUCTS, INC. v. THE UNITED STATES

[No. 327-74. Decided December 15, 1976]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; liquidated damages assessment; duress; constructive acceleration claim; Government counterclaim.**—Plaintiff seeks review under Wunderlich Act standards of an adverse decision of the Armed Services Board of Contract Appeals, including recovery of an amount withheld as liquidated damages, reversal of the Board's allowance of the Government's counterclaim for additional liquidated damages not previously withheld, and review of the Board's rejection of plaintiff's alleged additional costs incurred because of defendant's actions amounting to a constructive acceleration. Plaintiff was awarded some 16 indefinite quantity supply contracts, with delivery dates ranging from December 1970 through September 1971. By mid-June 1971 plaintiff was either already delinquent or about to become so in its deliveries under all of the contracts. Negotiations ensued whereby plaintiff's opportunity to continue performance was conditioned on its agreement to reasonable extended delivery dates and inclusion of provision for liquidated damages. Plaintiff claims that defendant's actions in negotiating time extensions and addition of liquidated damages constituted unlawful duress, that allowance of a curtailed time extension was a constructive acceleration, that since defendant's counterclaim was not timely pleaded administratively it is barred, that assessment of liquidated damages respecting the then non-delinquent contracts is unenforceable for lack of consideration, and that inclusion of an incorrect ASPR reference in the liquidated damages provision invalidated the same. It is *held* (1) that the Board's disposition of the liquidated damages claim is correct on this record; (2) that the claim of constructive acceleration fails; (3) that defendant may assert its counterclaim here;

Syllabus

(4) that there was consideration supporting the addition of liquidated damages respecting the then non-delinquent contracts; and (5) that plaintiff may not disavow the mutual understanding reached during negotiations despite the reference to the incorrect ASPR. Plaintiff has failed to establish that the Board's decision was legally erroneous, arbitrary, capricious or unsupported by substantial evidence. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is allowed and the petition is dismissed. Judgment is entered for defendant on its counterclaim for $4,324.21.

**Contracts; duress; what constitutes.**

[1] The contracting officer's threat to place the delinquent or about to be delinquent contractor on the Contractor Experience List unless the contractor offered reasonable firm extended delivery dates and agreed to inclusion of liquidated damages does not constitute unlawful duress, since the contracting officer was not seeking to re-impose the original delivery schedule but sought only to establish a specific new schedule. In so doing, the contracting officer was merely following guidelines developed by this court concerning waiver by the Government of its right to terminate a contract where the contractor has failed to meet the contract delivery date, and acted well within the scope of his responsibility in threatening termination and placing the contractor on said List.

United States ⇐ 66

**Contracts; duress; what constitutes.**

[2] Mere aggressiveness of a Government representative in pursuing his duties, such as during a contracting officer's negotiations concerning time extensions beyond the original delivery date, can hardly rise to the status of coercion.

United States ⇐ 66

**Contracts; disputes; administrative findings; material fact established by record not found; duty of court or trial judge to make findings.**

[3] Where the administrative board has failed or declined to make a relevant finding of fact, the court may properly decide the issue without returning the case to the board because, although the evidence may be disputed, it is of such a nature that as a matter of law the board could have made only one finding of fact. Under such circumstances, remand would be an empty ritual having no place in a rational decision-making process.

United States ⇐ 73(15)

**Contracts; performance; acceleration of work; constructive acceleration.**

[4] Where a plaintiff has failed to establish that the Government, either expressly or by conduct, agreed to plaintiff's request for a 4 to 6-month time extension, since a time schedule was no longer in

existence because of plaintiff's delinquency, defendant's allowance of a 2 to 3-month extension cannot be considered a constructive acceleration of plaintiff's obligation to perform the contract work.

United States ⇐ 70(34)

**Contracts; counterclaim; estoppel.**

[5] Under 28 U.S.C. § 2415(f) and this court's Rule 40(a), the Government may assert any counterclaim against an opposing party that arises out of the transaction or occurrence that is the subject matter of the opposing party's claim. Thus, since plaintiff raised the subject matter of the contract in its claim before the court, defendant may assert its counterclaim for liquidated damages although they were not administratively asserted until 2 years after damages were incurred. Furthermore, absent evidence of some damage or prejudice suffered by plaintiff as a direct result of defendant's delay in asserting the counterclaim, plaintiff's claim of equitable estoppel must fail.

Courts ⇐ 450

**Contracts; damages; liquidated damages; consideration.**

[6] Although there was only an expectancy of delinquency respecting some of plaintiff's contracts, a single consideration (i.e. time extensions on delinquent contracts) may support several promises, including the addition of a liquidated damages provision to all contracts.

United States ⇐ 66

**Contracts; damages; liquidated damages; consideration.**

[7] The inclusion of a liquidated damages clause involves in its very nature an exchange of consideration since each party to the contract thereby sacrifices an otherwise existing right to prove actual damages in any subsequent litigation with respect thereto and, in effect, settles in advance a potential future dispute.

Contracts ⇐ 65(2)

**Contracts; damages; liquidated damages; referenced ASPR.**

[8] Although the ASPR referenced in the liquidated damages clause in exchange for a time extension was the incorrect provision in that it related to termination of fixed-price construction contracts and assessment of liquidated damages on an overall basis rather than relating to fixed-price supply contracts, the subject assessment of liquidated damages on a per-item basis was not thereby invalidated where the evidence shows that the parties during negotiations actually agreed to a per-item rate and the clause contained wording necessary to assess the proper amounts. Furthermore, there is no evidence that the erroneous inclusion as such worked any hardship on the contractor.

United States ⇐ 73(1)

**Contracts; interpretation; contemporaneous construction of parties.**

**[9] A party cannot, after a controversy has arisen, arbitrarily abandon the contract interpretation it acted on to the other's knowledge when their relations were harmonious.**

Contracts ⇐ 170(1)

*Paul C. Hill*, attorney of record, for plaintiff. *Douglas M. Coombs*, of counsel.

*Lynn J. Bush*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Raymond B. Benzinger*, of counsel.

---

Before SKELTON, NICHOLS, and KUNZIG, Judges.

PER CURIAM: This case comes before the court on plaintiff's request, filed February 9, 1976, for review by the court of the recommended decision of Trial Judge Lloyd Fletcher, filed January 6, 1976, pursuant to Rule 166(c), on plaintiff's motion and defendant's cross-motion for summary judgment and on defendant's motion, filed May 10, 1976, that the court adopt the recommended decision of the trial judge. Upon consideration thereof, together with the briefs and oral argument of counsel, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the decision as the basis for its judgment in this case. It is, therefore, concluded that plaintiff has failed to establish that the decision of the Armed Services Board of Contract Appeals was legally erroneous, arbitrary, capricious or unsupported by substantial evidence. Accordingly, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is allowed and plaintiff's petition is dismissed. Judgment is entered for defendant on its counterclaim in the amount of $4,324.21.

OPINION OF TRIAL JUDGE

FLETCHER, *Trial Judge:* In this contract dispute, the plaintiff, Simmonds Precision Products, Inc., pursuant to the familiar standards of the Wunderlich Act (41 U.S.C. §§ 321–22), challenges the finality of the adverse decision by the Armed Services Board of Contract Appeals and seeks recovery of $11,087.97 withheld by the Government as

liquidated damages under multiple contracts for the supply of aircraft parts and equipment. Simmonds' appeal from the contracting officer's adverse decision was not only denied by the Armed Services Board of Contract Appeals; the Board further allowed a counterclaim by the Government for $4,324.21 in additional liquidated damages not previously withheld. The Board also rejected a $22,000 claim by plaintiff for its alleged additional costs incurred because of Government actions which it says amounted to a constructive acceleration. Since the Board's disposition of the liquidated damage claim appears clearly correct on this record, its findings and decision on those claims are sustained for reasons set forth below. On the claim of constructive acceleration, the plaintiff's petition must be dismissed.

The facts involved will be briefly summarized. Simmonds had been awarded some 36 indefinite quantity supply contracts for aircraft parts and equipment with various delivery dates ranging from December 27, 1970, through September 30, 1971. For reasons mentioned below, by mid-June 1971, Simmonds was either already delinquent, or about to become so, in its deliveries under all of these contracts. By then the Government had become so concerned over the imminent delinquencies that it sent its procurement contracting officer (PCO), William Rehrer, to the Simmonds plant for the purpose of investigation and negotiation of new delivery dates. Rehrer spent the afternoon of June 15, 1971, discussing with plaintiff's personnel new delivery dates for 17 delinquent contracts under which plaintiff had indicated it would be unable to make timely deliveries. Negotiations continued into June 16, 1971 with Rehrer pressing hard for firm delivery dates and stating that as a part of any extension of such dates, the Government would require the addition of liquidated damages provisions to not only the delinquent contracts but also to those contracts which while not yet delinquent might well become so. Paul C. Hill, Esquire, plaintiff's general counsel and manager, joined the negotiations and insisted that any revised delivery dates could not be firm dates, but merely the best estimates that could be projected at the time. Rehrer responded that he had to have firm delivery dates determined by the following day when

he would be departing the plant, and that if firm dates were not set by that time, he might have to put plaintiff's name on the so-called "Contractor Experience List," *i.e.*, a list of those contractors whose capability must be evaluated prior to the award of any contract.

On June 17, the parties met again in a final effort to work out a specific agreement. At this conference, plaintiff did provide new delivery dates, many of which it asserted were necessarily "padded" to insure timely compliance. At this time, plaintiff's representative also described the reasons for the delays it had experienced without, however, attempting to assess the specific impact of any particular delay.

Several of the delays which had seriously handicapped plaintiff were beyond its control, and were given sympathetic consideration by the Government. These delays included: (1) an anti-trust suit filed against the company by the Government and a union (IUE), as a result of which Simmonds had to divest itself of part of its operations; (2) interference by the union with attempts by plaintiff to sell part of its business, accompanied by walkouts and slowdowns; (3) an injunction obtained against the company which had delayed it for over a year in moving its operations from Long Island City to Vergennes, Vermont; and (4) the failure of several of Simmonds' suppliers to fill orders placed with them. Plaintiff claimed that these delays were of sufficient magnitude as to justify a four to six-month extension in the delivery dates, but the Government did not agree. The Government representative instead countered with a proposal of a two to three-month extension as more reasonable.

The time of extension was not the only point of dispute in these negotiations. Another problem revolved around the liquidated damages provisions which the Government demanded in exchange for any time extensions. Defendant had originally insisted upon a rate of one percent per day per delinquent item shipped, with a maximum rate of 25 percent. But plaintiff was able to bargain these rates down to one-tenth of one percent a day per delinquent item, not to exceed 13 percent. With respect to liquidated damages, two different sets of contracts were involved, one set assigned originally to the Long Island City plant and already de-

linquent, and the other set assigned to the Vergennes, Vermont plant and not yet delinquent. On the latter set of non-delinquent contracts, the parties agreed to a liquidated damages rate of one-twentieth of one percent per delinquent item, with a maximum of 13 percent.

The clause, as finally included, provided for liquidated damages as follows:

> * * * [*In*] *accordance with ASPR 7-603.39* at a rate of 1/10 of 1% per day [1/20 of 1% for non-delinquent contracts] with a not to exceed maximum rate of thirteen (13) percent. [Emphasis supplied.]

However, the ASPR provision referenced in this clause was the wrong provision. ASPR 7-603.39 is for "Termination for Default-Damages for Delay-Time Extensions," and is designed for use in fixed-price *construction* contracts rather than for fixed-price *supply* contracts such as the present ones.

Plaintiff's contract manager watched the contracting officer include the erroneous ASPR in the contracts and asked, "Is that the clause you are putting in?" The contracting officer merely answered in the affirmative and nothing more was said about it between the parties. Even when the contract modifications were formally executed, no one raised a question concerning the erroneous ASPR reference.

Plaintiff again became delinquent in the performance of its contracts after the adoption of the June 17 modification. Whereupon, the Government assessed and withheld liquidated damages of $11,087.97, a figure determined by application of the per-item rate as agreed upon between the parties, rather than by application of the ASPR clause. The contracting officer issued a final decision on December 22, 1972, denying delivery schedule extensions which would have remitted the liquidated damages. On August 21, 1973, the contracting officer assessed an additional $4,324.21 which the Government had failed to deduct through an oversight. Plaintiff's appeal was denied by the Armed Services Board of Contract Appeals.

Plaintiff sets forth five distinct grounds for relief in this case. First, it alleges that the actions of defendant's procurement contracting officer (PCO) in negotiating the time extensions and addition of liquidated damages clauses constituted

unlawful duress because, in plaintiff's view, the PCO had previously waived the original delivery dates, and thus any subsequent insistence on those dates was wrongful and coercive. Second, plaintiff asserts that it was entitled to a four- to six-month extension of the production schedules, and therefore the defendant's allowance of only a two- to three-month extension was a constructive acceleration of the contractor's obligations. Third, since the Government did not assert its $4,384.21 counterclaim for previously unassessed liquidated damages until two years after those damages arose, plaintiff urges that the counterclaim is barred as untimely. Fourth, plaintiff attacks the liquidated damages provisions which were included in the then nondelinquent Vergennes contracts, as being unenforceable for lack of consideration. Finally, plaintiff argues that the inclusion of the incorrect ASPR reference in the liquidated damages provisions invalidated those provisions in their entirety. Each of these claims will be discussed separately.

The claim of duress stems from the fact that the Government had acquiesced in Simmonds' early production delays and had urged it to continue production in spite of the various difficulties the company was then encountering. Since it was apparent that plaintiff was about to become seriously delinquent in its performance, it now argues that by its acquiescence, the Government "waived" any right to insist upon the original delivery dates and accepted such delinquencies as might occur. Therefore, it says that when the PCO rejected as unreasonable its request for a four- to six-month extension, and also threatened to place plaintiff's name on the Contractor Experience List and terminate the contracts for default, such threats amounted to duress.

In rejecting the same argument made before it, the Board correctly held that:

> We are unable to find pressure exerted by the Government on appellant of such nature and force as to constitute coercion or duress sufficient to void the extended delivery dates and the liquidated damages clauses. The contracting officer's threat to place appellant on the Contractor Experience List unless it offered firm proposed

> delivery extension dates under the so-called "Long Island" contracts was reasonable. Appellant was delinquent, or admittedly certain to become so, under those contracts. The Government had the right, on 17 June 1971, to terminate the delinquent contracts for default, there having been no waiver of delivery dates, as held hereinafter. Instead it gave appellant the opportunity to continue performance, provided appellant offered reasonable extended delivery dates and agreed to inclusion of liquidated damages clauses in both the delinquent contracts and those not yet delinquent. The contracting officer raised the specter of the CEL only when appellant initially suggested extensions of four to six months, which the contracting officer considered unreasonable in light of information he had that several military aircraft had been grounded for lack of parts and equipment appellant was to have delivered under these contracts. Although appellant offered some reasons for its delinquency, they were not sufficient * * * to constitute excusable causes of delay justifying longer delivery extensions than those accepted by the contracting officer. Under these circumstances there was nothing offensively coercive or unfair in his threat to place appellant on the CEL. ASBCA No. 18110 at p. 8.

The record fully supports these findings by the Board, but plaintiff continues to ignore the fact that in his negotiations, the PCO was not seeking to re-impose the original delivery schedules which, plaintiff says, the Government had previously "waived". Rather, the PCO sought only to establish a specific new schedule for deliveries. From the facts known to him, a two to three-month time extension seemed adequate and reasonable, and he threatened default if some such reasonable schedule were not forthwith submitted to him by the contractor. In so doing, the contracting officer appears merely to have followed the guidelines developed by this court concerning waiver by the Government of its right to terminate a contract where the contractor has failed to meet the contract delivery date. See, for example, *DeVito* v. *United States*, 188 Ct. Cl. 979, 413 F. 2d 1147 (1969) and the court's recent decision in *International Telephone & Telegraph Corp.* v. *United States*, 206 Ct. Cl. 37, 509 F. 2d 541 (1975). In the latter case, the court summarized the

waiver after breach doctrine as follows at 206 Ct. Cl. 49–50, 509 F. 2d at 547–48:

> Under the *DeVito* rule, in a waiver after breach situation, time may again become essential and the Government may regain the right to terminate a delinquent contractor for default, if (1) the Government unilaterally issues a notice under the contract's Default clause establishing a reasonable but specific time for performance on pain of default termination, or (2) the parties bilaterally agree upon a new delivery date. * * *

Since the contracting officer believed that a two to three-month extension was a reasonable, specific time for performance, and since there is no evidence to contradict that belief, he appears to have acted well within the scope of his responsibility in threatening termination and listing plaintiff on the CEL. *See, Bailey Specialized Buildings, Inc.* v. *United States*, 186 Ct. Cl. 71, 404 F. 2d 355 (1968) and *Pelliccia* v. *United States*, 208 Ct. Cl. 278, 525 F. 2d 1035 (1975). Plaintiff's assertion that the PCO was "overbearing" and impatient, while suggestive of a personality conflict between the negotiators, is of doubtful relevance. Mere aggressiveness of a Government representative in pursuing his duties can hardly rise to the status of coercion.

In addition, there is no real indication that plaintiff's representatives negotiated from such a condition of weakness as to be forced against their will into conceding all Government demands. To the contrary, plaintiff's relative strength in the negotiating sessions is evidenced by the fact that its representatives managed to reduce substantially the extent of the proposed liquidated damages provisions from one percent per day with a 25 percent limit, to $\frac{1}{10}$th of one percent per day with a 13 percent limit.

Therefore, since there was neither coercive action by defendant, nor sufficient weakness in plaintiff's position to force it involuntarily to accept defendant's terms, a claim of duress cannot be sustained here. See, *United States* v. *Bethlehem Steel Corp.*, 315 U.S. 289, 300 (1942).

Plaintiff's second claim for relief is based upon a theory of constructive acceleration. The Board refused to consider that issue on the ground that it had not been mentioned during the Board hearing and was only raised on post-trial brief ap-

parently as an afterthought. On motion for rehearing, however, the Board allowed the acceleration claim to be docketed as a separate appeal although such appeal was later dismissed without prejudice, on plaintiff's motion, pending the outcome of the case here.

Despite the absence of a Board decision, however, the court may properly decide the issue without returning the case to the Board because, even though the evidence may be disputed, "it is of such a nature that as a matter of law the Board could have made only one finding of fact" (*Maxwell Dynamometer Co.* v. *United States*, 181 Ct. Cl. 607, 631, 386 F. 2d 855, 870 (1967)), and it is clear from the facts actually found by the Board on the duress issue discussed above that plaintiff cannot establish a valid claim of constructive acceleration.

With respect to the latter issue, the Board has found that plaintiff failed to establish entitlement to its requested four- to six-month extension of delivery dates. Although it made general allegations of delays and production difficulties beyond its control, such allegations in the Board's view of the evidence were "unsupported by evidence other than vague generalities." ASBCA No. 18110, p. 8. There was no showing made by plaintiff regarding the impact and extent of such delays (even if excusable) on plaintiff's performance. Certainly at no time did the Government indicate, either expressly or by conduct, that it would agree to the requested four- to six-month extension. In fact, the proposal was flatly rejected so there was never any longer a time schedule in existence from which the agreed-upon two- to three-month extension could be considered an acceleration. Absent an affirmative act by the Government setting forth a more lenient standard than the one eventually imposed, there obviously can be no acceleration. See, for example, *Guaranty Const. Co., Inc.*, GSBCA No. 3109, 70–2 BCA ¶8483 (1970). Hence, on any remand for consideration of this issue, the Board would have no choice but to find for the defendant and "[S]uch an empty ritual has no place in a rational decision-making process." *Maxwell Dynamometer, supra.*

There is equal lack of merit in plaintiff's attack on the defendant's counterclaim. Its argument is that the Government may not now assert its counterclaim "on principles of

equitable estoppel," because the contracting officer did not assess the $4,324.21 (which includes interest) until approximately two years after the damages were incurred. However, the argument ignores the right of the Government, unmistakably granted by 28 U.S.C. § 2415(f), to assert any counterclaim against an opposing party "that arises out of the transaction or occurrence that is the subject matter of the opposing party's claim." See, also, Rule 40(a) of the Rules of the Court of Claims. Since the plaintiff raised the subject matter of the contract in its claim, defendant is entitled to assert a counterclaim arising out of those same contracts.

Plaintiff also raises the doctrine of equitable estoppel as barring the Government from pursuing its counterclaim. In asserting such equitable defense, however, plaintiff must introduce evidence of some damage or prejudice suffered by it as a direct result of the Government's delay in asserting its counterclaim. Since plaintiff has shown no such evidence here, the Board's allowance of the counterclaim was proper and must be upheld.

Plaintiff's next contention is that the liquidated damages provision inserted into the so-called "Vergennes" contracts was unenforceable for lack of consideration. The basis for this assertion seems to be that, since the Vergennes contracts were not yet delinquent at the time the liquidated damages clause was added thereto, the Government relinquished no right and hence furnished no consideration for the inclusion of the clause. However, the Board correctly found this argument unpersuasive. It overlooks the fact that the Vergennes contracts were merely part of the overall package of contracts being negotiated at one time by the same parties. It is well-settled that, in such a situation, a single consideration (*i.e.*, time extensions on the delinquent contracts) may support several promises, including the addition of a liquidated damages provision to all contracts. WILLISTON ON CONTRACTS, § 137A (3d Ed.). In any event, it would seem that the inclusion of a liquidated damages clause involves in its very nature an exchange of consideration since each party to the contract thereby sacrifices an otherwise existing right to prove actual damages in any subsequent litigation with respect thereto and, in effect, settles in advance a potential

future dispute. See WILLISTON, *supra*, § 128 fn. 18. See, also, *ITT Gilfillan, Inc.* v. *United States*, 200 Ct. Cl. 367, 373, 471 F. 2d 1382, 1386 (1973).

Finally, plaintiff asserts that the erroneous reference in the liquidated damages clause to ASPR 7–603.39 invalidates the entire clause because the ASPR provision provides for liquidated damages on the overall contract, and thus establishes an unenforceable penalty. In this connection, plaintiff objects strenuously to the Board's finding that, since the plaintiff's negotiator was well aware of the erroneous reference and failed to alert the contracting officer thereto, the contractor could not afterwards complain of the error.

However, the Board's decision on this issue is fully supported by substantial evidence. First, the overall damages provision provided by the erroneously included ASPR, even if it could be considered a penalty, was never intended by the parties here to be the measure of damages. To the contrary, the evidence is overwhelming that the parties actually agreed to a per-item rate of liquidated damages rather than to an overall rate as contemplated by the ASPR provision. The clause (except for the erroneous ASPR reference) and the negotiations concerning it clearly contemplated a per-item rate, a result which the parties reached only after bargaining from a higher per-item figure. Plaintiff confuses the issue by arguing that it understood one *delinquency* would cause default of the entire contract. That may be true, but overall delinquency is a separate issue from overall damages. There is no persuasive evidence to indicate that the parties ever agreed upon "overall" damages, regardless of their intentions as to an "overall" delinquency provision.

Secondly, it appears incontrovertible that plaintiff knew of defendant's erroneous reference to ASPR 7–603.39 at the time the contracting officer was drafting the clause. Indeed, plaintiff states in its main brief at pp. 17–18:

> Looking over defendant's shoulder, plaintiff clearly saw from the ASPR defendant was reading, that this clause was for construction contracts.

Plaintiff then asked the contracting officer, "Is that the clause you are putting in?" When defendant's contracting officer replied "Yes," plaintiff had nothing further to say about it.

Syllabus

On these facts, it is manifest that plaintiff accepted the error for its own purposes with knowledge that the referenced clause ran contrary to the agreement at the time. As stated by the court in *J. A. Maurer, Inc.* v. *United States*, 202 Ct. Cl. 813, 824, 485 F. 2d 588, 594 (1973):

> A party cannot, after a controversy has arisen, arbitrarily abandon the contract interpretations it acted on to the other's knowledge when their relations were harmonious.

The original agreement of the parties, according to the well-supported findings of the Board, contemplated a per-item damages rate. Having failed to disavow such mutual understanding at any time during the negotiations or at the time of the incorporation of the ASPR provision, the plaintiff may not disavow it now. Moreover, since there is no evidence that the erroneous inclusion of the ASPR clause as such worked any hardship upon the plaintiff, damages having been assessed according to the original agreement, the harmless error does not require invalidation of the damages provision actually agreed upon by the parties.

CONCLUSION

The plaintiff has failed to establish that the decision of the Armed Services Board of Contract Appeals was legally erroneous, arbitrary, capricious, or unsupported by substantial evidence. Accordingly, plaintiff's motion for summary judgment is denied, the defendant's cross-motion for summary judgment is allowed, and plaintiff's petition dismissed. Judgment is entered for defendant on its counterclaim in the amount of $4,324.21.

---

546 F. 2d 395

## WICKHAM CONTRACTING CO., INC. v. THE UNITED STATES

[No. 327-75. Decided December 15, 1976]
ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; interpretation; ambiguity; necessity for seeking clarification; defective drawing.**—Plaintiff seeks review of a decision of the Armed Services Board of Contract Appeals under Wunderlich Act

Syllabus

standards, the Board having denied plaintiff's claim for additional costs by way of contract price adjustment and a time extension premised upon a scale error in the contract drawing. The contract related to replacement of underground electrical cable at a military installation. The single contract drawing contained two different scales: the figures adjacent the bar scale were 1″=200′ and the "Plan" section figures were 1′=200′. It is undisputed that the latter figures were and should have read 1″=200′. Defendant's bid officer, because of the percentage differential between plaintiff's low bid and the Government estimate requested verification of the bid. The bid was confirmed although the contractor at that time was aware of the two different scales. The Board found that plaintiff based its bid on the Plan scale figures, that the possibility of an error relative to 1′=200′ was manifest, noting that the 1′ scale was unusual, and obligated the contractor to seek clarification before bidding. It is *held* that the record amply supports the Board's conclusions which are fully compatible with case law. Since plaintiff was aware of the drawing error and refused an opportunity to withdraw its bid based on the error, it is not entitled to recover. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Pleading and practice; defenses; failure to brief or argue.**

[1] A possible challenge to the decision of the administrative board not briefed or argued by the plaintiff is deemed to have been abandoned.

United States ⇐ 73(15)

**Contracts; disputes; administrative findings; burden of proving error in.**

[2] In Wunderlich Act review, plaintiff has the burden to specify the facts and circumstances contained in the administrative record necessary to overcome the finality that otherwise attaches to Board findings. It is not the court's function to remedy this deficiency by an independent and/or *de novo* review of the record.

United States ⇐ 73(15)

**Contracts; disputes; administrative decisions; substantial evidence; scope of review of Court of Claims.**

[3] In Wunderlich Act review, the court reviews the record to determine the existence of substantial evidence supportive of the Board's findings; if substantial evidence exists, the court is bound by such findings even though the record would support contrary and/or modified findings in some respects.

United States ⇐ 73(15)

**Contracts; interpretation; ambiguity; clarification, necessity for seeking.**

[4] Where a patent and glaring discrepancy exists in a contract drawing, and such discrepancy would be recognized by a reasonable bidder, a burden is imposed on such bidder to seek clarification of

the discrepancy from an appropriate government official before submitting a bid if the bidder, subsequent to an award to it, hopes to rely on its unilateral resolution of the discrepancy issue as a basis for a subsequent contract price adjustment claim. Whether a bidder knew or did not know of this type of discrepancy prior to bid submission is not a governing factor.

United States ⟸ 70(29)

**Contracts; specifications; defective specifications; liability of Government.**

[5] If a contractor enters into a contract aware of defective specifications, it is not entitled to recover on a claim based thereon.

United States ⟸ 70(29)

**Contracts; bids; confirmation of bid; Government request for.**

[6] A contractor's confirmation of its bid after a Government request for verification thereof is a warning that the bid might be inadequate, and in the present instance since the contractor and the Government at that time were aware of the drawing scale error, the confirmation of the bid was an unreasonable assumption of risk by the contractor.

United States ⟸ 64

**Contracts; Government obligation to contractor; bid cancellation after opening.**

[7] Where both the Government and the contractor prior to contract award were aware of the drawing scale error and the contractor confirmed its bid offer upon the Government's request for verification, the Government was under no obligation on its own to cancel the invitation for bids as defective and to resolicit bids. 32 C.F.R. § 2.404-1(b)(1) is permissive not mandatory.

United States ⟸ 64

*Eugene Drexler*, attorney of record, for plaintiff.

*Donnie Hoover*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS, and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed September 14, 1976, pursuant to Rule 54(b)(3)(iii), requesting that the court adopt, as the basis for its judgment in the case, the recommended decision of Trial Judge Thomas J. Lydon, filed July 22, 1976, pursuant to Rule 166(c) on plaintiff's motion and defendant's cross-motion for summary judgment, since plaintiff has failed to

file a request for review by the court thereof and the time for so filing pursuant to the Rules of the court has expired. Upon consideration thereof, without oral argument, since the court agrees with the recommended decision, as hereinafter set forth, it hereby grants defendant's motion and adopts the decision as the basis for its judgment in this case. Therefore, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and plaintiff's petition is dismissed.

OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* This government contract case involves a review, under standards of the Wunderlich Act (68 Stat. 81, 41 U.S.C. §§ 321–22 (1970)), of a decision by the Armed Services Board of Contract Appeals (Board), denying plaintiff's claims for (1) additional costs by way of a contract price adjustment, and (2) a 2-month time extension. Both claims were premised on a scale error contained on a contract drawing. (*Wickham Contracting Co.*, ASBCA No. 19069, 75–1 BCA ¶11,248.)[1] On review, it is concluded that the Board decision denying plaintiff's claims is correct in fact and in law.[2]

[1] Plaintiff moved for summary judgment seeking to overturn the Board decision "on the grounds that the decision is arbitrary, capricious, erroneous in law and against the weight of the evidence." Defendant cross-moved for summary judgment in support of the Board decision and responded in opposition to plaintiff's motion for summary judgment. Plaintiff, by letter dated July 1, 1976, to the trial judge, waived its right to file a response to defendant's cross-motion for summary judgment.

[2] In denying plaintiff's claim for a 2-month extension of time, which plaintiff sought to protect itself against any possible liquidated damage assessment, the Board found that while defendant unreasonably delayed responding to plaintiff's request for a contract modification formally asserting the fact that a 1′=200′ scale on the contract drawing was erroneous, plaintiff acted unreasonably if it delayed the start of the work pending an answer to its modification request. The Board noted that once plaintiff was on the work site there was no uncertainty or ambiguity as to how the work was to be performed. Plaintiff's president conceded that once on the site the scale error on the drawing was obvious. The Board found that plaintiff did not need any clarification or interpretation from the government as to how to proceed with the work. The record supports the Board's findings. Moreover, plaintiff does not contest this portion of the Board decision, presumably because no assessment of liquidated damages was made against plaintiff. Under the circumstances, plaintiff is considered to have abandoned any challenge to the Board decision on the 2-month time extension claim. *See Nossen v. United States*, 189 Ct. Cl. 1, 18, 416 F. 2d 1362, 1371 (1969).

Opinion of Trial Judge

On July 23, 1973, plaintiff was awarded a construction contract by the Corps of Engineers, U.S. Army Engineer District, New York, for Replacement of Primary Underground Cable at the Military Ocean Terminal, Bayonne, New Jersey. The contract price was $44,000. In essence, the contract required the furnishing and installation of four manholes, underground electrical cable, a concrete duct bank within which to run the cable, and certain accessories for the overall system. The contract documents contained only a single drawing and it provided the setting for the dispute which resulted in the Board decision here under review.

The contract drawing contained two different scales. To the left of the title block, in the lower right-hand corner of the drawing, was a calibrated graphic or bar scale 3 inches long with marked footage designations. Immediately to the left of this graphic or bar scale were the figures; 1″=200′.[3] In the middle section of the drawing under the heading "Plan" appeared the following figures: Scale 1′=200′. It is undisputed that the 1′=200′ scale was a drafter's error and should have read 1″=200′. The Board found that plaintiff based his bid on the Plan scale of 1′=200′. The issue is whether plaintiff is entitled to recover additional costs of performance because of its reliance on the erroneous scale set out on the contract drawing which caused it to underbid.

Initially, it must be observed that plaintiff's petition and moving brief lack the substantive particularity, supported by appropriate record references, necessary to overcome the finality that otherwise attaches to findings made by a Board whose decision is subject to Wunderlich Act review. It is not the court's function to remedy this deficiency by an independent and/or *de novo* review of the record. *Jet Constr. Co.* v. *United States*, 209 Ct. Cl. 200, 203–04, 531 F. 2d 538, 540–41 (1976). *Hicks Corp.* v. *United States*, 203 Ct. Cl. 65, 68, 487 F. 2d 520, 521 (1973). A review of the record, however, discloses the existence of substantial evidence supportive of the Board findings. Under these circumstances, the court is bound by such findings even though the record would support

[3] To eliminate confusion with respect to quoting measurement scales, underscoring has been used rather than quotation marks throughout this opinion.

contrary and/or modified findings in some respects. *Allied Contractors, Inc.* v. *United States*, 176 Ct. Cl. 1095, 1098–99 (1966).

The Board found that the possibility of an error relative to the scale 1′=200′ on the drawing was manifest. Parenthetically, plaintiff challenges this Board finding on the sole ground that it is irrelevant. Such a challenge, under the circumstances, is without merit. The Board noted that use of a 1′ scale was unusual. Moreover, the presence on the drawing of another scale figure 1″=200″ created a patent discrepancy.[4] The Board concluded that plaintiff should have recognized the possibility of a drawing error when bidding.[5] It is established that plaintiff was under an obligation to study all aspects of the contract drawing before submitting its bid, *see Richardson Camera Co.* v. *United States*, 199 Ct. Cl. 657, 665, 467 F. 2d 491, 496 (1972), and its failure to note the discrepancy in the scale data on the drawing rightly impinges on the reasonableness of its bid submission. *See Martin Lane Co.* v. *United States*, 193 Ct. Cl. 203, 217, 432 F. 2d 1013, 1020 (1970).

Under circumstances where a patent and glaring discrepancy exists in a contract drawing, and such a discrepancy

[4] The Board found no need to decide whether other factors should be considered in this regard. It specifically referred to the fact that utilization of the erroneous scale would produce bizarre results relative to the size of surrounding features and landmarks set out on the drawing. For example, use of the erroneous scale would result in roughly 3, 6 or 8 feet wide streets instead of actual width streets of approximately 57, 75 or 100 feet. Such a reading of the drawing would be unreasonable. *See Blake Constr. Co.* v. *United States*, 202 Ct. Cl. 794, 798 (1973). The Board noted that if plaintiff had used the erroneous scale to determine the dimensions of the drawing landmarks it would have immediately confirmed the drawing scale error. Accordingly, plaintiff's argument that there was nothing on the face of the drawing to show which scale was appropriate is not entirely accurate. Another factor was that a site inspection would have plainly revealed the scale drawing error, a fact readily conceded by plaintiff's president. While the Instructions To Bidders contained a clause advising that bidders should visit the site and that failure to do so would not relieve bidders from responsibility for properly estimating the cost of the work, plaintiff's president testified he rarely visited work sites before submitting bids because most of his work was interior in nature and infrequently involved outside work.

[5] The Board also found that plaintiff was not actually aware of the error at the time it prepared and submitted its bid, was actually misled by the drawing error, and actually used the erroneous scale in preparing its bid estimates. Although plaintiff was unable to produce its bid work papers in support of its position that its bid was prepared on the basis of the erroneous scale, the Board accepted the testimony of plaintiff's president that this was so because of the absence of any inconsistent evidence.

would be recognized by a reasonable bidder, there is a burden imposed on such a bidder to seek clarification of said discrepancy from an appropriate government official before submitting a bid, if the bidder, subsequent to an award to it, hopes to rely on its unilateral resolution of the discrepancy issue as a basis for a subsequent contract price adjustment claim. *Merando, Inc.* v. *United States*, 201 Ct. Cl. 23, 475 F. 2d 601 (1973); *Space Corp.* v. *United States*, 200 Ct. Cl. 1, 5–6, 470 F. 2d 536, 539 (1972); *Beacon Constr. Co.* v. *United States*, 161 Ct. Cl. 1, 7, 314 F. 2d 501, 504 (1963). This proposition is for application in situations where a bidder knew, as well as in situations where a bidder should have known, of the discrepancy. The latter situation is present in this case. *Allied Contractors, Inc.* v. *United States*, 180 Ct. Cl. 1057, 1064–65, 381 F. 2d 995, 1000 (1967). Indeed it has been said that whether a bidder knew or did not know of the discrepancy prior to submitting its bid is not a governing factor. "It is the existence and type of the discrepancy, not necessarily the contractor's actual knowledge of it that imposes a burden of inquiry on the contractor * * *." *HRH Constr. Corp.* v. *United States*, 192 Ct. Cl. 912, 920–21, 428 F. 2d 1267, 1272 (1970).[6]

The Board recognized the applicability of the above legal proposition to the instant situation, although it did not cite any of the above cases, but was dissuaded from basing its decision thereon because of its finding that the government had knowledge of the drawing error prior to contract award.[7]

[6] Article 2 of the General Provisions of the contract provided in pertinent part. "* * * In case of discrepancy either in the figures in the drawings, or in the specifications, the matter shall be promptly submitted to the Contracting Officer, who shall promptly make a determination in writing * * *." Further, Clause SP–2(c) of the Special Provisions of the contract provided in pertinent part: "The contractor shall check all drawings furnished him immediately upon their receipt and shall promptly notify the Contracting Officer of any discrepancies. * * * The contractor shall compare all drawings and verify the figures before laying out the work and will be responsible for any errors which might have been avoided thereby."

[7] The government's estimator, the authorized representative of the contracting officer for the purpose of preparing the government's estimate of the cost of the work and for initiating drawing corrections, noticed the scale error when preparing the estimate from the drawing in question. The record does not indicate when precisely he discovered the error. His testimony was to the effect the error was an obvious one. However, contrary to the responsibility imposed on him, the estimator did not report the scale drawing error to his superiors, or to the contracting officer, nor did he initiate any Information For Bid (IFB) amendment for distribution to prospective bidders. The Board

(Continued)

*See Helene Curtis Indus., Inc.* v. *United States*, 160 Ct. Cl. 437, 443–44, 312 F. 2d 774, 777–78 (1963). The Board also alluded to the well established principle that the government impliedly warrants the suitability of its drawings for their intended use. *See Thompson Ramo Wooldridge, Inc.* v. *United States*, 175 Ct. Cl. 527, 538, 542, 361 F. 2d 222, 230, 232 (1966). At this stage, the Board in essence, viewed both parties as being at fault. *See Aerojet-General Corp.* v. *United States*, 199 Ct. Cl. 422, 436–39, 467 F. 2d 1293, 1302–03 (1972). The Board synthesized the matter as follows:

> Other things being equal, we might well regard the Government's duty to disclose its actual knowledge to the bidders, including appellant, as a higher duty superseding a bidder's duty to recognize and seek clarification of an obvious drawing error of which it did not have actual knowledge. However, in the present case later events presented appellant with a last clear chance to avoid damage from the drawing error.

Like the Board, I find no need to resolve this troublesome question of which duty prevails when on a collision course since another basis exists, as was found by the Board, on which one could properly rest a decision.

On bid opening on June 26, 1973, it was disclosed that five bids had been submitted to perform the contract work. The low bid was $44,000, submitted by plaintiff, and the high bid was $85,500. The next lowest bid was $51,942. The government's estimate for performing the work was $63,000. Under standard procedures, the percentage differential between plaintiff's low bid and the government's estimate required the government to seek verification from plaintiff of its bid.

(Continued)
imputed the estimator's actual knowledge of the drawing error to the government and hence to the contracting officer. However, there is no evidence in the record that the contracting officer, or any other responsible government official connected with the award of plaintiff's contract, was actually aware of any drawing error prior to the opening of the bids, and there is no Board finding that the contracting officer knew at the time of award that plaintiff's bid was based on the erroneous scale. *Cf. Wender Presses, Inc.* v. *United States*, 170 Ct. Cl. 483, 486–87, 343 F. 2d 961, 963 (1965). While there is language in *Wender Presses* on which one could question, the Board's imputation of knowledge of the error to the contracting officer under the circumstances, I do not accept nor reject the Board's opinion in this regard because of the disposition of the case on other grounds and the fact that a bid verification was requested in this case, a crucial fact missing in the *Wender Presses* case.

On June 27, 1973, the bid opening officer of defendant telegrammed plaintiff for verification of its bid. Failing to receive a prompt response to this verification inquiry, a subsequent telephone conversation between plaintiff's president and the bid opening officer took place. The Board found it undisputed that in this telephone conversation plaintiff's president called the bid opening officer's attention to the presence of two different scales on the drawing. The Board found as a fact that plaintiff actually became aware of the drawing scale error when its president examined the drawing to verify his bid.[8]

The bid opening officer asked plaintiff's president to either confirm his bid or ask for withdrawal of his bid based on a bid mistake. Plaintiff subsequently confirmed his bid without qualification. In his testimony, as noted by the Board, plaintiff's president believed he had bid on a correct interpretation, *i.e.*, there was no error in his bid in that it was based on the scale 1′=200′. He testified it was the government's error, not his error. He gave no consideration to the fact that this scale was erroneous, a fact he was aware of when called upon to verify his bid, and since his bid was based thereon it would constitute a mistake in bid. He further testified he did not want to withdraw his bid because it might affect his ability to get future bonding as well as his credibility. There is nothing in the record which would tend to support plaintiff's fears in this regard. Moreover, such reasons are not deemed sufficient to excuse plaintiff from the conscious act it performed in entering into the contract fully aware that its bid was based on an erroneous scale on the contract

[8] The Board found it unnecessary to resolve the conflicting testimony as to whether plaintiff's president told the bid opening officer that he had bid on the basis of the 1′=200′ scale, and that if the correct scale was 1″=200′ plaintiff intended to seek a contract modification after award to it, and as to whether the bid opening officer told plaintiff's president that the 1′=200′ scale was erroneous. Contrary to plaintiff's assertion, there is no Board finding that the government knew that plaintiff's bid was based on the erroneous scale and that this served to explain its ostensibly low bid. Since the record is conflicting on these matters, the court cannot find them to be facts on any independent review of the evidence. *Cf. Maxwell Dynamometer Co.* v. *United States*, 181 Ct. Cl. 607, 631, 386 F. 2d 855, 870 (1967). Accordingly, the contentions of each party that the other, aware of the contrary interpretation, must be bound thereby because it executed the contract alert thereto, must be rejected for lack of any necessary factual predicate. *Compare Chris Berg, Inc.* v. *United States*, 192 Ct. Cl. 176, 426 F. 2d 314 (1970), relied on by plaintiff, and *WPC Enterprises, Inc.* v. *United States*, 163 Ct. Cl. 1, 323 F. 2d 874 (1963), relied on by defendant.

drawing. *Massman Constr. Co.* v. *United States*, 102 Ct. Cl. 699, 716–19, 60 F. Supp. 635, 642–44, *cert. denied*, 325 U.S. 866 (1945).

On July 19, 1973, defendant sent plaintiff a Notice of Award, which was followed on August 3, 1973, by a fully executed contract, together with a Notice To Proceed. On August 8, 1973, plaintiff wrote defendant advising that "[a]ctual field measurements indicate a discrepancy between the 1′=200′ scale indicated on contract drawing File No. 7690–1601 [and] actual field conditions." Plaintiff asked the government to investigate immediately and to modify the contract as required. On September 12, 1973, the contracting officer wrote plaintiff that the scale 1′=200′ on the drawing was erroneous but that the graphic scale 1″=200′ on the drawing was correct. After a further exchange of correspondence, plaintiff on November 13, 1973, submitted to the contracting officer its claim for $54,500, representing the increase in the contract price due it because of its under bid resulting from the erroneous scale on the contract drawing. The Board action here under review resulted from the contracting officer's formal denial of the claim.

The Board, in denying plaintiff's claim for a price adjustment based on the erroneous scale on the contract drawing, concluded as follows:

> When the Government requested verification of appellant's bid, appellant by its own admission focused on the two scales on the drawing. We have found (para. 23) that appellant at that time actually became aware of the drawing error. Thus at that time, after bid opening and before award, appellant and the Government were both on equal footing, actually aware of the drawing error.
>
> In such a situation, where appellant had failed to notice the obvious error before bidding, and then before award became actually aware of its failure, but refused to admit its oversight and avail itself of the profferred [sic] opportunity to assert a mistake in bid, we conclude that appellant acted unreasonably. In a situation where it could have avoided the consequences of the Government's failure to disclose the drawing error and of its own failure to see the error sooner, it nevertheless consciously chose to ignore the error and accept the contract at its original price. In doing so, it assumed the risk of the higher costs.

The record in this case fully supports the Board's conclusions set out above. Moreover, these conclusions are fully compatible with case law. If a contractor enters into a contract aware of the fact of defective specifications, it is not entitled to recover on a claim based on these defective specifications. *R.E.D.M. Corp.* v. *United States*, 192 Ct. Cl. 891, 902–03, 428 F. 2d 1304, 1310 (1970). At the time it was requested to verify its bid, plaintiff was aware of the drawing scale error, and whatever duty the government may have had before to advise plaintiff of the error faded. Both sides had equal knowledge of the error at this point. *Donald M. Drake Co.* v. *United States*, 194 Ct. Cl. 549, 555, 439 F. 2d 169, 172 (1971). Plaintiff confirmed its bid after being asked to verify it. This verification request was certainly a warning that the bid might be inadequate. At this time the drawing error was known to both sides. Confirmation of its bid under these circumstances was surely "an unreasonable assumption of risk" by plaintiff. *Highway Products, Inc.* v. *United States*, 208 Ct. Cl. 926, 530 F. 2d 911 (1976); *see also Rixon Electronics, Inc.* v. *United States*, 210 Ct. Cl. 309, 319, 536 F. 2d 1345, 1351 (1976).[9] If plaintiff embarked on a "ruinous course of

[9] Plaintiff complains that if it withdrew its bid it would have been deprived of a fair chance to get the contract. The Board noted that plaintiff could have avoided this by requesting cancellation of the IFB as defective and requesting resolicitation of bids. Plaintiff sees this as a duty imposed on the government without any request by plaintiff. Under the circumstances, there was no such obligatory duty and plaintiff cites no regulation or case imposing any such duty on the government. ASPR 2.404–1(b)(i), (32 C.F.R. 1974), cited by plaintiff, advises that the contracting officer *may* cancel an IFB because of inadequate or ambiguous specifications. It does not say he *must* cancel. (Emphasis supplied.) On the other hand, it is reasonable to suppose that on a resolicitation plaintiff would not have received an award. Its underbid claim of $54,500 when added to its bid of $44,000 would produce a total bid of $98,500. Such a bid figure would be $35,500 over the government's estimate of $63,000 and $46,558 over the second lowest bidder. There is no reliable evidence in the record relative to the actual drawing scale used by the other four bidders in preparing their bid estimates. The Board's parenthetical supposition that these bidders "most likely" bid on the basis of the correct scale is not considered a factual finding. However, the record is crystal clear that the government's estimate was based on the correct scale. Finally, plaintiff argues that the integrity of the bidding system was violated because the government did not reject plaintiff's bid which was based on an erroneous drawing scale, citing ASPR 2.301 and ASPR 2.404–2 (a), (b), and (d). As indicated earlier, there is no finding that the government knew at the time of bid verification or at the time of award that plaintiff's bid was based on the erroneous drawing scale. It would seem to me that to allow recovery herein might do more of an injustice to the integrity of the bidding system for, in effect, plaintiff, as high bidder, obtained a contract at the expense of four lower bidders.

Syllabus

action," it was a journey it chose to take with its eyes wide open. It certainly did not act reasonably under the circumstances and the Board rightly denied its claim. *See Ling-Temco-Vought, Inc.* v. *United States*, 201 Ct. Cl. 135, 475 F. 2d 630 (1973); *see also Snyder Corp.* v. *United States*, 68 Ct. Cl. 667, 676 (1930). Since plaintiff was aware of the drawing error at the time it entered into the contract, refusing an opportunity to withdraw its bid based on the drawing error, it is not entitled to recover additional costs by way of a contract price adjustment based on said error. *See Union Painting Co.* v. *United States*, 198 F. Supp. 282, 284 (D.C. Alaska 1961).

CONCLUSION

For the above reasons, defendant's cross-motion for summary judgment is granted, plaintiff's motion for summary judgment is denied and plaintiff's petition is dismissed.

---

548 F. 2d 915

## SPERRY FLIGHT SYSTEMS DIVISION OF SPERRY RAND CORPORATION v. THE UNITED STATES

[No. 40-75. Decided January 26, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; negotiated procurement; requirement for submission of cost and pricing data; exemption from cost disclosure; severance of issues by Board.**—This case is before the court for review under Wunderlich Act standards of a decision of the Armed Services Board of Contract Appeals. Plaintiff entered into a 2-year contract to supply to the United States, upon either a priced or unpriced order, various types of aeronautical equipment which it manufactured. During the contract period plaintiff filled three orders for unpriced ML-1 remote compass transmitters and was paid at its catalog prices, but a new contracting officer subsequently refused to accept plaintiff's proposed catalog price for the item and demanded cost data which plaintiff declined to furnish. Thereupon, the contracting officer finally rejected plaintiff's catalog price and established a lower price for the item. On appeal from this ruling plaintiff requested of the board and was granted a severance of the issues; the board hearing and decision was limited to the question of plaintiff's entitlement to payment of its proposed catalog price without

Syllabus

furnishing supporting cost data and postponed were proceedings determining, at defendant's behest, the price payment to which plaintiff was entitled if the board held that plaintiff was required to furnish said data. The board upheld the right of the contracting officer to require submission of the cost data. Plaintiff has contended that, since its units were based on a catalog price for a commercial item it was exempt from submission of cost and pricing data pursuant to the Truth in Negotiations Act, 10 U.S.C. § 2306(f), and applicable procurement regulations. Defendant contends that if plaintiff does not prevail on the catalog price issue, the case must return to the board for determination of defendant's objections to the reasonableness of the contracting officer's price which should be considered in light of plaintiff's disclosed cost data. Plaintiff asserts that if it does not prevail here, it has a right to stand on the contracting officer's price and opposes reopening the price decision. In affirming the decision of the board, it is *held* for the reasons stated that the action taken by the contracting officer was authorized by law and stands as a proper exercise of his authority, the exemption from the Truth in Negotiations Act being permissive only. It is also *held* that the record does not reveal that the parties agreed to end the litigation with recovery based on the contracting officer's price, and accordingly further proceedings before the board on the reasonableness of said price is in order. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Contracts; Boards of Contract Appeals; review of decision of contracting officer; scope of review; severance of issues.**

[1] Absent record evidence that the parties agreed to abide by the price set by the contracting officer for a sole-source commercial item purchased by the Government on a negotiated procurement basis after the contractor refused to furnish cost and pricing data to substantiate its proposed higher catalog price, a challenge by the Government to the reasonableness of the contracting officer's price may be considered at a later date by the Board where the latter at the contractor's request limited the appeal hearing to the contractor's entitlement to its proposed catalog price without having to furnish supporting cost data and left for a future date determination of the price payment to which the contractor would be entitled if it had to submit said cost data, particularly in view of the general understanding that once the cost data were released the Government's challenge to the contracting officer's price was part of the appeal.

United States ⊂ 55

**Contracts; negotiated procurement contracts; cost and pricing data; discretion of contracting officer; exemption from cost disclosure.**

[2] The statutory language of 10 U.S.C. § 2306(f) envisions no mandatory exemption from cost disclosure as applied to the negotiated purchase of a catalog-priced item ordered under a basic

ordering procurement where, as here, the amount involved is expected to exceed $100,000. ASPR 3-801.1 observes that sound pricing depends primarily upon the exercise of sound judgment, and the decision to contract at a particular price—a responsibility resting with the contracting officer alone—is inherently a judgmental process demanding broad discretion. In the last analysis, the contracting officer must satisfy himself that the negotiated contract price is reasonable.

United States ⊂⊃ 55

**Contracts; negotiated procurement contracts; cost and pricing data; discretion of contracting officer.**

[3] Where, based on a Government cost-price analysis, the intracorporate selling price was considerably less than the contractor's proposed catalog price for the item being purchased by the Government on a negotiated procurement basis, such disparity is sufficient by itself to justify the action of the contracting officer in requiring the contractor to furnish cost and pricing data substantiating the catalog price, such action being authorized by law and constituting a proper exercise of the discretionary authority vested in the contracting officer. The fact that in earlier procurements of the item other contracting officers paid the proposed catalog price without demanding cost data is immaterial since it is the current contracting officer's judgment that prevails.

United States ⊂⊃ 55

**Contracts; interpretation; prior conduct of parties, departure from.**

[4] Although departure from practices previously adhered to by an agency in the administration of its contracts may, under certain circumstances, furnish the basis for an actionable claim against the United States, it is essential in such situations that this sequence of previous conduct between the contracting parties be such that it can be fairly regarded as establishing a common basis of understanding for interpreting their expressions and other conduct. The Government must necessarily retain flexibility in its procurement contracting program.

United States ⊂⊃ 74(1)

*Steven L. Cohen*, for plaintiff. *Daniel J. O' Neill*, attorney of record. *Chadbourne, Parke, Whiteside & Wolff*, of counsel.

*Alan L. Ferber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This contract case comes before the court on appeal by way of plaintiff's request for review of the opinion of Trial Judge

John P. Wiese, filed on April 19, 1976, and defendant's motion to adopt that opinion with modifications. At issue is the finality, under Wunderlich Act standards, 41 U.S.C. §§ 321, 322 (1970), of a decision of the Armed Services Board of Contract Appeals (the board), which upheld the right of a contracting officer to require the submission of cost data from a contractor in support of a proposed catalog price for a commercial item being purchased by the Government on a negotiated procurement basis. *Sperry Flight Sys.—Div. of Sperry Rand Corp.*, ASBCA No. 17375, 74–1 BCA ¶10,648. The case has been submitted to the court on the briefs and oral arguments of counsel. Upon consideration thereof the court agrees with portions of the trial judge's opinion and adopts, with minor modifications, parts I and IIB of that opinion. Part IIA of the opinion is substantially revised, for the reasons set forth in the discussion of that part, below. As explained herein, the board's decision is affirmed.

## I. *Facts*

On October 31, 1969, plaintiff and the United States, acting through the Navy's Aviation Supply Office, entered into a 2-year contract pursuant to which plaintiff was to supply, upon order, various types of aeronautical equipment that it manufactured. This contract, more descriptively referred to by the parties as a basic ordering agreement, contemplated two types of orders, priced and unpriced. The priced order, as the name implies, was an order issued to the contractor by the Navy after price and delivery terms had been agreed upon; an unpriced order, on the other hand, meant an order issued in the absence of prior agreement on price.

The mechanics for the pricing of an unpriced order called for the contractor's submission of a proposed price for each item within 45 days after receipt of an order together with such price supporting information as the contracting officer might request. Within 60 days thereafter, the contracting officer was required to indicate whether the price quoted was acceptable to the Government or whether further negotiations would be necessary. In the event of a failure to agree on price, the matter was then to be resolved by resort to the standard "disputes clause" procedures.

On December 15, 1971, the order which eventually gave rise to this litigation was issued. It was an unpriced order calling for delivery of 660 model ML–1 remote compass transmitters, also sometimes referred to in the trade as flux valves. This is an electrical induction sensing device which measures the earth's magnetic field and it is used primarily in aircraft as part of a directional gyrocompass system. There had been three previous unpriced orders for ML–1 transmitters processed under the instant contract and on each of these past occasions the contractor had proposed and was paid its then current catalog price for the item. However, in this instance, the then newly assigned contracting officer declined to accept the contractor's proposed price, namely, its catalog price of $351 per unit, and asked instead for substantiating cost data. This data the contractor declined to furnish.

Then, and now, the refusal to supply the requested data rested on the contention that under the relevant statute, generally referred to as the Truth In Negotiations Act, 10 U.S.C. § 2306(f) (1970), and the procurement regulations issued pursuant thereto, such data was not to be required when—as was claimed to be the case here—the item involved was a commercial item previously sold in substantial quantities to the general public and the price proposed was either (i) the established catalog price for such item, or (ii) a price "based upon" such a catalog priced item.

There followed an extensive written exchange of views as well as negotiations between the parties, all of which proved fruitless. Thereafter, the contracting officer—whose initial request for cost data had, in the interim, been specifically approved by his superior—issued a final decision, which unilaterally established a price for the ML–1 at $204, and set forth specific reasons for the rejection of the contractor's proposed price of $351. These reasons, which were repeated among the board's own later findings in the matter, were the following. First, the catalog price of the ML–1 (*i.e.*, the proposed price) was not an acceptable pricing criterion to the Government because that unit had not been sold in substantial quantities to the general public. Second, the proposed price of the ML–1 could not be considered to be "based upon" the established catalog price of the functionally comparable

"thin valve" because the latter unit, even though admittedly similar to the ML–1 and concededly sold in substantial quantities to the general public, had previously been sold to the Air Force at a price 42 percent less than its established catalog price. Third, the price at which the ML–1 unit had been sold by the company's manufacturing facility to its marketing facility (the intracorporate selling price) was only $138.78.

Based upon these three considerations, the contracting officer considered it inappropriate to accept the proposed price of $351. Instead, using certain limited financial data then available to him, he determined that a fair and reasonable price was $204. As a consequence of this determination, and plaintiff's disagreement with it, the matter was carried on to the board for hearing and determination, and the result there, as previously noted, was in favor of the contracting officer. The case here followed next.

## II. *Discussion*

### A. *Severance of Issues*

Before the board plaintiff requested and was granted a severance of the issues in the case. As a result of the severance, the board hearing and decision was limited to the question of plaintiff's entitlement to payment of its proposed catalog price without having to furnish supporting cost data. Postponed to a future date were the proceedings that would determine, at defendant's behest, the price payment to which plaintiff was entitled should it have been decided, in the first board decision, that plaintiff was required to furnish the cost data in support of its proposed price upon request of the contracting officer. Plaintiff sought this severance for the highly practical reason that it would need to bring in the cost data to counter a separate challenge by defendant to the contracting officer's decision that $204 was a reasonable and fair price, and yet, in plaintiff's counsel's words, "if we are to put in cost data at this time to meet the Government's objections with regard to the contracting officer's finding as to reasonable price, we moot the appeal [on the need to furnish cost data at all]." When plaintiff received the board

decision adverse to it on the catalog price issue, it came directly to this court. Accordingly, the board has never had the opportunity to hear evidence and rule on defendant's challenge to the contracting officer's price determination.

Defendant argued to the trial judge that, since the board had yet to determine a reasonable price based on the disclosure of the cost data, this appeal was interlocutory and premature, and should not be heard until after further consideration by the board. The trial judge answered that well-settled practice, not outweighed by the judicial policy against piecemeal litigation, allows the court to decide an appeal "taken on a substantively important [to the outcome of the case] and distinctly severable issue * * * that has been treated as such by the Board and that has been fully acted upon by the Board." *Cf. Cutler-Hammer, Inc.* v. *United States*, 189 Ct. Cl. 76, 81, 416 F. 2d 1306, 1309 (1969). Defendant no longer maintains this jurisdictional challenge, but now shifts its position to argue a point not explicitly raised before the trial judge. Defendant now says that if the court finds against plaintiff on all the issues presently appealed from the board's decision, the case must return to the board for a determination of defendant's objections to the $204 price, then to be considered, of course, in light of the plaintiff's disclosed cost data. Plaintiff counters that it has a right to stand on the contracting officer's $204 price, which it expresses a willingness to do if it does not succeed in persuading the court on the catalog price issue, and accordingly opposes reopening the contracting officer's price decision. Since we resolve the issues in defendant's favor in part IIB, *infra*, it becomes necessary for us to address the effect of the severance of issues on defendant's entitlement to the price redetermination that it seeks.

First of all, we think it important to note what the parties are not contending. No issue is raised regarding the Government's right to question before the board its own contracting officer's decision that, even lacking the supporting cost data he previously requested of plaintiff and was refused, he had sufficient information available to him to determine that $204 was a fair and reasonable price for the ML–1. It is not contended that, by operation of law, plaintiff's recovery may not

be reopened by the board and redetermined to be below that which the contracting officer allowed, nor is it argued that the Government's defense before the board and here is limited to supporting, not challenging, what the contracting officer decided. Both sides seem content to rely upon *Blount Bros.* v. *United States*, 191 Ct. Cl. 784, 801–02, 424 F. 2d 1074, 1084–085 (1970), for the rule that proceedings at the board level are de novo and, therefore, that the Government counsel may present to the board whatever arguments he deems appropriate, even if these are at odds with the contracting officer's ruling. Further, it is not urged that the contracting officer's determination that he had sufficient information in front of him to choose a price figure for the ML–1 was discretionary and not subject, short of an abuse of discretion, to second-guessing by the board. The contracting officer was not compelled to issue a ruling on price, of course, but could have declined to make any determination at all under Armed Services Procurement Regulation (ASPR) 3–807.6, 32 C.F.R. § 3.807–6 (1969), had he thought that plaintiff's refusal to yield its cost data left him too ill-informed. Finally, there is no challenge to the Government's right, assuming the applicability of our decision in *Roscoe-Ajax Constr. Co.* v. *United States*, 204 Ct. Cl. 726, 499 F. 2d 639 (1974), to question the contracting officer's determination on sufficiency of price information even though plaintiff disputes only the officer's alleged disregard of plaintiff's legal entitlement to the payment of its catalog price. Since these matters have not been briefed or argued orally by the parties, we intimate no ruling on them.

Plaintiff bases its right to stand on the contracting officer's $204 price decision solely on a stipulation that the parties supposedly entered at the outset of the board hearing. Defendant denies that any agreement was reached allowing plaintiff to end this litigation with a $204-per-unit recovery, and our review of the transcript of the board proceedings persuades us that defendant is correct. Throughout the colloquy among counsel and the hearing examiner there was an assumption that the Government, if it prevailed in the first hearing, would further litigate before the board—

assuming a settlement was not reached in the meantime—the correctness of the $204 price, and would do so with plaintiff's ML–1 cost data in hand. Plaintiff's counsel plainly acknowledged that the "Government has also put into issue, as is their right, the other finding of the contracting officer in terms of reasonable price." He then asked for the severance of the catalog price issue from the Government's challenge to the $204 price in order to avoid bringing in the supporting cost data to defend against the Government's challenge even as he was arguing that that data need not be furnished at all, as a matter of law. The Government counsel before the board responded that he had no objection to the severance, stating:

> [T]he board could never fix a price, a reasonable price, without cost data, and Sperry says that we don't have to furnish it. I suspect that the board would first have to say, "Sperry, you have to furnish cost data."
>
> Then, if the parties cannot agree on pricing they would have to come back here.

This statement is hardly a stipulation that the litigation may end once plaintiff is informed that it may not withhold its cost data from the Government. Defendant clearly looked forward to arguing before the board, in the absence of a compromise settlement, that the cost data, perhaps together with the information that the contracting officer had in his possession, points toward a unit price other than $204.

Plaintiff makes much of the following exchange between hearing examiner Thompson and its own counsel, Mr. Cohen:

> MR. THOMPSON: * * * I take it that Appellant [plaintiff here] agrees that if Appellant should lose on a catalog item issue, and so forth, the contracting officer's decision will stand as to the issue of reasonable price.
>
> MR. COHEN: Yes, Your Honor.
>
> MR. THOMPSON: It would not be necessary to render a new decision.
>
> MR. COHEN: No; no, it would not.

Plaintiff views these words as permission from the board for plaintiff to let the contracting officer's decision on price "stand." However, the Government counsel agreed to no such view, nor did the hearing examiner go beyond stating only

that a new decision from the contracting officer would not be sought. In light of the parties' general understanding that the Government's challenge to the price determination was part of the appeal, the examiner could not have meant to say that a further decision could not be sought from the board on the Government's challenge, once the cost data were released and a settlement not reached. The examiner went on to state that "if the board did render a decision adverse to the Appellant on that [the catalog price] issue it would stand as a preliminary decision reducing the issues on the appeal and the appeal could simply stand in suspense, pending arrangements for disposing of the second problem [the Government's objection to the $204 price]." Further litigation on the price reasonableness issue, making use of the disclosed cost data, was thus clearly contemplated.

Since plaintiff's contention regarding the stipulation before the board is without merit, and since we agree with defendant on the points discussed in part IIB, the case may now proceed before the board on the Government's challenge to the reasonableness of the price set by the decision of the contracting officer.

### B. *Catalog Price and Cost Data*

As to the merits of the case, extensive reexamination of the board's decision is not called for. Two points compel a decision in the Government's favor. First, there is no legal support for the contractor's principal contention, namely, that the Government may not require cost data where it is involved in the negotiated purchase of a catalog-priced commercial item that is otherwise sold in substantial quantities to the general public. Even if the supportive facts were true, that is, that the item involved qualified as a commercial item that had previously been sold in substantial quantities to the public, still the argument would have no merit in this situation.

The statutory obligation to furnish cost and pricing data applies to every negotiated procurement where, as here, the amount involved is expected to exceed $100,000. And, to the extent that there may be exceptions to this requirement, such are wholly permissive in nature for the statute plainly says

"[t]hat the requirements * * * [for submission and certification of cost and pricing data] *need not be applied* to contracts * * * where the price negotiated is based on * * * established catalog or market prices of commercial items sold in substantial quantities to the general public * * *." 10 U.S.C. § 2306(f) (1970). Clearly, the statutory language envisions no mandatory exemption from cost disclosure such as plaintiff claims. It is urged that legislative history counsels a different reading of the quoted language, but, like the board we see nothing in the several references which plaintiff offers in support of this proposition that demonstrates any basis whatsoever for assuming that the words "need not be applied" should actually be read to say "shall not be applied." [Emphasis in above quote supplied.]

Nor is such a mandate to be found in the pertinent procurement regulations. Indeed, just the opposite is true. ASPR 3–800 through 3–813, 32 C.F.R. §§ 3.800–3.813 (1969) (Price Negotiation Policies and Techniques), make apparent, first of all, that Government procurement, when carried out on a negotiated contract basis, depends for its success on a well-informed contracting officer, one having knowledge not only of cost and pricing techniques in general, but also knowledge in particular of the product or service in question, including its uses and technology, its costs, alternate sources of supply and prevailing market prices. To this end, the regulations contemplate that various sources of information shall be made available to the contracting officer, including not only field audits, engineering studies and technical appraisals prepared by in-house staff, but also contractor-supplied cost and pricing data.

But equally as important as the need for reliable information in the negotiation process is the need also to recognize that the decision to contract—a responsibility that rests with the contracting officer alone—is inherently a judgmental process which cannot accommodate itself to absolutes, at least not without severely impairing the quality of the judgment called for. That effective contracting demands broad discretion is plainly recognized, for the regulations observe at the outset that "[s]ound pricing depends primarily upon

the exercise of sound judgment * * *." ASPR 3–801.1.[1] Thus, in keeping with this theme, with respect to catalog-priced commercial items, the regulations undertake to set out no rigid set of standards by which to gauge price reasonableness. True, the regulations do say as to such items that "[a]s a general rule, cost or pricing data should not be requested," but the same regulation, ASPR 3–807.3(c), goes on to point out that if "despite the willingness of a number of commercial purchasers to buy an item at such a catalog or market price, the purchaser (*e.g.*, the contracting officer) finds that that price is not reasonable and supports such finding by an enumeration of the facts upon which it is based, cost or pricing data may be requested if necessary to establish a reasonable price * * *."[2]

In this case the contracting officer did reject the contractor's proposed price for lack of reasonableness—a consideration which brings us now to the second point for discussion. As noted earlier, among the grounds upon which the contracting officer had based his refusal to accept the contractor's proposed price was the fact that a cost-price analysis undertaken by the Government had reported the intracorporate selling price of the ML–1 unit to be $138.78. In the testimony before the board that fact was brought out again and a finding to such effect was included by the board in its opinion.

In our view, the intracorporate selling price of the ML–1 unit, $138.78, was a factor sufficient by itself to justify the

[1] The same point is said even more explicitly in later regulations. Specifically, by the time of the contracting officer's decision in this case, March 28, 1972, ASPR 3–807.3 (which deals in general with required cost and pricing data submissions), had been expanded to include, *inter alia*, the following language:

"(4) If the cost or pricing data required by paragraph (a) of this section is not adequate for the purpose, the contractor shall be required to support subcontract cost estimates below the minima set forth in paragraph (b) (1) (i) and (ii) of this section, by any additional data or information needed to establish a reasonable contract (not necessarily subcontract) price. *In the last analysis, the contracting officer must satisfy himself that the negotiated contract price is reasonable.* For this purpose, he should require whatever additional contractor or subcontractor data is reasonably necessary. * * *." ASPR 3–807.3(b)(4) (1972) (emphasis added).

Although the quoted paragraph is aimed principally at insuring the adequacy of cost support for subcontractor pricing, the essential point here—and the point which the paragraph makes plain—is that, regardless of all supporting cost submissions, the contracting officer's final obligation is to "satisfy himself that the negotiated contract price is reasonable."

[2] The quoted 1969 regulation, ASPR 3–807.3(c), has appeared as ASPR 2–807.3(f) in all regulations issued since 1973.

action that was taken by the contracting officer in rejecting the contractor's proposed price. Given the two figures which the contracting officer had before him—or, more to the point, the disparity between the two figures—it was altogether appropriate that he should decline to accept the proposed catalog price of $351 and insist, instead, upon substantiating cost data. Clearly, without the benefit of such data, the contracting officer would have been hard pressed to accept as reasonable a price to the Government that was fully two and one-half times greater than the seller's own indicated purchase cost. This is not to say, of course, that the price differentials might not have been entirely justifiable; there well might be appropriate justifications. We mean only to say that, given the circumstances, an explanation was clearly called for and the contracting officer was well within his rights under the regulations quoted above, in asking for the contractor's cost data.

There were also other grounds upon which the contracting officer had relied in supporting his request for cost data and these too were considered by the board. However, these additional grounds need not be examined anew, for whether the board was right or wrong with respect to the findings that it made concerning them is really beside the point. All that matters here is that the action taken by the contracting officer was authorized by law and that the action would stand as a proper exercise of his authority even if it were supported only by the single factual consideration discussed above, namely, the disparity between the proposed catalog price and the indicated purchase cost to the plaintiff. This was enough to lead one to conclude, at least initially, that the catalog price was not a reasonable price.

Nor would it matter that in procurements of the ML–1 subsequent to the one in issue, the Government consented to pay the proposed catalog price without demanding the submission of cost data. It has been pointed out that the decision as to whether or not to contract at a particular price is inherently a matter of judgment—a circumstance which can obviously yield differing results depending upon the individual administrator and the facts before him. Accordingly, the decision that was made by the contracting

officer in this instance cannot be made either right or wrong by the contrast with the judgment others have chosen to follow. The only question is whether what was done by the contracting officer in *this* procurement was done in accordance with authority granted by the law. As to this last point, no question can seriously be raised: ASPR 3-807.3(c) expressly declares that cost data may be requested if a contracting officer finds, for reasons he has enumerated, that a proposed catalog price is not reasonable. There was a plainly sufficient reason presented in this case. In short, it is the instant contracting officer's judgment that counts; not the judgment of others who may succeed him.

There is a further argument made by plaintiff which addresses the fact that all previous Navy procurements of the ML-1 were completed without cost data submissions. Based upon this fact, plaintiff advances the contention that the Government may not now reverse course and abandon a practice upon which plaintiff has come to rely.

This argument too lacks merit. Although departure from practices previously adhered to by an agency in the administration of its contracts may, under certain circumstances, furnish the basis for an actionable claim against the United States, *see L. W. Foster Sportswear Co.* v. *United States*, 186 Ct. Cl. 499, 509, 405 F. 2d 1285, 1290-291 (1969), it is essential in such situations that this sequence of previous conduct between the parties to the agreement (*i.e.*, their course of dealing) be such that it can be "fairly * * * regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." RESTATEMENT (SECOND) OF CONTRACTS § 249 (Tent. Drafts Nos. 1-7, 1973). In other words, a course of dealing can supply an enforceable term to a contract (or may even supplement or qualify that contract) provided that the conduct which identifies that course of dealing can reasonably be construed as indicative of the parties' intentions—a reflection of their joint or *common* understanding.

Such was the case, for example, in *L. W. Foster Sportswear Co.* v. *United States*, *supra*, where this court held that the Government could not insist upon performance in strict accordance with contract requirements when, in previous in-

stances involving plaintiff's manufacture of the same item under essentially identical specifications, the closely related predecessor procuring activity had habitually recognized the need for, and allowed, deviations from its specified requirements. Regarding that situation, the court said:

> * * * Both the plaintiff and the Navy were aware of this past history, and necessarily relied upon it in entering into new contracts of the same type. We have no doubt that plaintiff would have a sound claim if the Navy had abruptly changed its practices under the same contract specifications. We likewise have no doubt that plaintiff would not have to indicate at the time it bid on the successor Navy contracts that it expected to obtain the same deviations. * * *. [186 Ct. Cl. at 509, 405 F. 2d at 1290–291.]

No comparable fact situation exists in this case. The reliance argument that plaintiff makes here is, at best, only a statement of its own unilateral assumptions concerning the Navy's expected future conduct. No facts are offered that would establish or even allow an inference that the Government, by having accepted plaintiff's catalog prices on past occasions, thereby intended to commit itself to continue such a practice into the future. Not only would there be no contractual purpose served by such a commitment, to the contrary, the idea abridges the flexibility that the Government must necessarily retain in order to carry out its purchases properly on a negotiated basis. In effect, what plaintiff argues for is a contract right that would undermine the authority and responsibility vested in a contracting officer to obtain for the Government the benefit of fair and reasonable prices. Even assuming such a result could lawfully be brought about, nothing has been shown here that would justify placing the Government in so irretrievable a position.

## CONCLUSION

For the reasons hereinbefore stated, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

Concurring Opinion by Judge Davis

DAVIS, *Judge*, concurring:

Joining in the court's opinion, I add some further considerations which, as I see it, puncture this plaintiff's claim even if one disagrees with the broader proposition that contracting officers have a general discretion to demand cost data whenever there is some preliminary reason to believe the demanded price may be excessive.

The contractor's case rests at bottom on its argument that the regulation affirmatively gave it a flat exception from the cost data requirement because the price of the flux valve (the ML–1 model) was an established catalog price of commercial items sold in substantial quantities to the general public, or at least was "based upon" the "thin valve" which did meet those characteristics. One can accept arguendo the contention that items satisfying these specific criteria are automatically exempted from the cost data requirement without holding for this plaintiff. The Armed Services Board of Contract Appeals confronted the point by finding that in any event the particular standards (on which plaintiff relies) were not satisfactorily met. First, the Board found in effect that the ML–1, though a catalog item, was not sold in substantial quanties to the general public—without doubt this determination had solid support in the record. Second, the Board found in substance that the catalog price of the ML–1 was not "based upon" the price of the "thin valve"; for this finding the tribunal largely rested, and quite properly, on the express testimony of plaintiff's marketing manager that the ML–1 price was not based on the price of the "thin valve" but on a number of factors.[1]

Another part of the regulation secondarily invoked by plaintiff limits, in the case of substantially similar items not technically "based on" the price of a publicly vended catalog item, the requirement for cost or price data "to that pertaining to the differences between the items" (*i.e.* between the item in question and the "similar" item sold publicly in substantial quantities) but only "if this limitation is consistent

[1] The Board referred to "the lack of any apparent relationship (confirmed by the quoted testimony of appellant's marketing manager) between the price of the ML–1 and the price of the thin unit * * *."

Syllabus

with assuring reasonableness of pricing result." [2] On the basis of the factors already mentioned plus the sole-source nature of the ML–1 and "the ability of the Air Force to obtain lower prices on the more complex thin unit," the board permissibly concluded, in my opinion, that the contracting officer could permissibly determine that in this instance the limitation was *not* consistent with assuring reasonableness of pricing result—that unanswered questions of reasonability still remained, even though the ML–1 and the "thin" unit might be "similar."

It follows that, even under the specific parts of the regulation on which plaintiff grounds its claim, it is not entitled to recover.

---

548 F. 2d 924

## FEC LIQUIDATING CORP., ETC. v. THE UNITED STATES

[No. 201–75. Decided January 26, 1977]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Taxes; income tax; corporate organizations and reorganizations; reorganization v. liquidation; gain on sale of corporate assets.**—In Counts One and Four of the petition plaintiff seeks to recover Federal income taxes it paid upon gains realized from its sale of a portion of Whittaker Corporation (W) common stock acquired along with W's assumption of certain of plaintiff's liabilities in exchange for substantially all of plaintiff's assets, pursuant to an Acquisition Agreement and Plan of Reorganization. Subsequently, as contemplated in a Plan of Complete Liquidation, plaintiff sold as much of the W stock as was necessary to purchase outstanding warrants and proceeded within 12 months to liquidate and dissolve, distributing to its shareholders the balance of W stock. In computing its tax returns, plaintiff included in gross income gains realized on the sales of W stock and paid the appropriate tax. It later filed claims for refund, contending that the gains need not

---

[2] This portion of the regulation provided (3.807.3(c)): "Where an item is substantially similar to a commercial item for which there is an established catalog or market price at which substantial quantities are sold to the general public, but the offered price of the former is not considered to be based on the price of the latter in accordance with 3–807.1(b)(2), any requirement for cost or pricing data should be limited to that pertaining to the differences between the items *if this limitation is consistent with assuring reasonableness of pricing result*" (emphasis added).

have been recognized by operation of Sec. 337 of the Code. Thereafter this suit was instituted. It is *held* that under the facts of this case plaintiff's exchange of assets for stock was a reorganization in purpose and effect; the sale of a part of the corporate assets to outsiders, incident to larger transactions of other kinds, liquidated those assets but was not a "complete liquidation." A reorganization occurring while plaintiff liquidated lost none of its vitality to control the tax consequences. Accordingly, the gains realized from the sale of W stock do not qualify for nonrecognition under Sec. 337. Defendant's motion for summary judgment on Counts One and Four is granted, plaintiff's motion is denied, and those counts are dismissed.

**Taxes; statutes; construction and operation; literal compliance.**

[1] A taxpayer's literal compliance with statutory criteria will not of itself entitle taxpayer to the desired tax treatment if, in a broad view, that result contravenes an underlying tax policy.

Internal Revenue ⟸ 236

**Taxes; income tax; corporate organizations and reorganizations; reorganization v. liquidation.**

[2] A corporate reorganization occurs where the owners of a business retain a proprietary interest in it as the enterprise continues under a modified corporate form. A complete liquidation involves either dissolution of a business conducted in corporate form, or the planned disassociation of the shareholders from the business if the enterprise continues; this definition focuses on the future conduct of the *business* enterprise rather than on any technical corporate procedure, such as dissolution under state law. These two types of transactions are conceptually incompatible—the transaction is taxed either as a reorganization or a liquidation, never both.

Internal Revenue ⟸ 365, 481

**Taxes; income tax; corporate organizations and reorganizations; gain or loss on sale of corporate assets.**

[3] Where, pursuant to agreement, plaintiff transferred substantially all of its assets to W corporation in exchange for some of W's common stock and W's assumption of certain of plaintiff's liabilities, and later plaintiff sold as much of the W stock as was necessary to discharge outstanding warrants against plaintiff's stock, and liquidated and dissolved within 12 months, distributing to its shareholders the balance of the W stock, since plaintiff's corporate enterprise continued in its corporate form and the shareholders at least for a time continued their investment in W, the gain realized from the sale of W stock does not qualify for nonrecognition under Sec. 337 of the Code, but the sale was a taxable transaction entered into in the course of a reorganization.

Internal Revenue ⟸ 492

Opinion of the Court

**Taxes; income tax; corporate organizations and reorganizations; "complete liquidation"; "reorganization".**

[4] The term "complete liquidation" is a term of art in tax law, apart from its meaning in corporate law contexts. The same is true of the term "reorganization" defined for tax purposes in Sec. 368 of the Code. Not every change in corporate form that might fall within the generic meaning of reorganization qualifies for tax treatment as such.

Internal Revenue ⇐ 365, 481

*Arnold Fisher*, attorney of record for plaintiff. *David W. Mills* and *Lowenstein, Sandler, Brochin, Kohl & Fisher*, of counsel.

*Allan C. Lewis*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

---

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

Plaintiff sues to recover the Federal income taxes it paid upon gains realized from its sale of two blocks of Whittaker Corporation common stock, which plaintiff had acquired in exchange for its assets. Both parties move for summary judgment on plaintiff's counts one and four, relating to its entitlement to the refund. Plaintiff's other counts are not the subject of the motions before the court, nor the subject of this opinion. Since we grant defendant's motions for summary judgment, however, we dismiss the portion of the petition that is affected.

The facts material to these motions are undisputed. On September 15, 1967, Whittaker Corporation executed an Acquisition Agreement and Plan of Reorganization, qualifying for tax-free treatment under §§ 361 and 368(a)(1)(C) of the Internal Revenue Code. Under the Agreement, plaintiff's predecessor, Fanon Electronics Industries, Inc., promised to transfer substantially all of its assets to a Whittaker subsidiary in exchange for Whittaker common stock and Whittaker's assumption of certain of plaintiff's liabilities. Fanon, however, had to pay certain creditors and purchase outstanding warrants against its stock. On December 14, 1967,

plaintiff's Board of Directors adopted a Plan of Complete Liquidation. Both the reorganization and liquidation plans contemplated, first, that plaintiff would sell that portion of its newly acquired stock in Whittaker as was necessary to obtain sufficient funds to purchase the outstanding warrants, and second, that plaintiff would proceed to liquidate and dissolve, distributing to its shareholders the balance of the Whittaker stock. The liquidation plan further provided that dissolution would be completed within twelve months. Three days after the Board's action, plaintiff and Whittaker consummated the reorganization exchange, and plaintiff immediately sold for cash 4,500 common shares of Whittaker. On January 10, 1968, plaintiff sold 1,276 additional shares. In computing its tax returns for the periods including these sales, plaintiff included in gross income the gain it realized on the sales of Whittaker stock and paid the appropriate tax. Now, after proper claims for refund, plaintiff contends that these gains need not have been recognized, by operation of § 337 of the Internal Revenue Code, and that it is entitled to a refund of the tax paid, plus statutory interest.

Section 337, on which plaintiff rests its claim, provides, in general, that if a corporation adopts a plan of "complete liquidation," it shall not recognize any gain or loss on sales of its property made during the next twelve months if by the end of that period it has distributed to its shareholders all of its net assets. We do not have here, as in *Ross Michael Simon Trust* v. *United States*, 185 Ct. Cl. 291, 402 F. 2d 272 (1968), the common controversy whether transactions are liquidations or reorganizations. The parties agree that plaintiff's reorganization plan qualifies under § 361. With respect to § 337, defendant concedes only that plaintiff met the literal requirements of the statute, in adopting a plan that could have been characterized as providing for complete liquidation, and distributing the assets within twelve months. Defendant then recalls the well-known rule that a taxpayer's literal compliance with statutory criteria will not of itself entitle the taxpayer to the desired tax treatment if, in a broad view, that result contravenes an underlying tax policy. This much plaintiff concedes, at least in theory. The issue is joined when defendant objects to plaintiff's effort to invoke

both §§ 337 and 361 to the same transaction, because, in defendant's view, corporate liquidations and corporate reorganizations are mutually exclusive, virtually by definition.

Defendant finds its support in a comment by Professors Bittker and Eustice, the recognized gurus of the corporate tax field, that the reorganization sections preempt § 337 from a transaction deemed to be reorganization rather than a liquidation, and moreover, that § 337 is ousted of jurisdiction even over sales of assets to "outsiders" in a liquidation occurring in the course of a reorganization. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶11.68 at 11–78 (1971). Bittker and Eustice draw this conclusion from or, at any rate, cite, a series of Tax Court decisions denying liquidation treatment to shareholders who liquidate their corporations shortly before reincorporating the operating assets in a separate but related corporation. *E.g.*, *Werner Abegg*, 50 T.C. 145 (1968); *Ralph C. Wilson*, 46 T.C. 334 (1966). *See also*, *e.g.*, *Davant* v. *Commissioner*, 366 F. 2d 874 (5th Cir. 1966); *James Armour, Inc.*, 43 T.C. 295 (1964). The Tax Court characterized the whole transaction in each of these cases as a reorganization, and not a liquidation in substance, and prevented the taxpayers from extracting from corporate solution the liquidated corporation's earnings and profits at only the cost of a capital gains tax. *Id.* Defendant generalizes from these cases that corporate liquidations and corporate reorganizations cannot coexist for tax purposes, and that hybrid transactions are taxed as reorganizations. Defendant explains that the cornerstone of a qualifying corporate reorganization is the shareholders' continuing their interest in the transferred business enterprise, although through a different corporate form, while a corporate liquidation occurs when the shareholders surrender their interests in the business and disassociate themselves from it. Insofar as the concept of continuity of interest is logically incompatible with the idea of shareholder disengagement from the business, defendant argues, any given transaction may be either a reorganization or a liquidation, but never both.

Plaintiff, on the other hand, denies that the concurrent operation of §§ 337 and 361 offends any tax policy. Sharing

defendant's homing instinct, plaintiff also seeks support in Bittker and Eustice's treatise but, predictably, in a passage of its own choosing:

> If the transferor corporation is required to recognize gain on the disposition of part of its assets, * * * because * * * part of its assets are sold to persons other than the acquiring corporation, is it nevertheless possible to claim the nonrecognition benefits of § 337 with respect to this gain * * *? Use of § 337 to obtain nonrecognition for gains realized on dealings with outsiders in the context of a reorganization cum liquidation of the transferor does not seem to be prohibited by any express provisions of the statute or by any compelling reasons of policy. Priority of the reorganization rules is probably justified where gain would be recognized under § 361, absent applicability of § 337, since § 337 ought not to be allowed to function as a backstop to § 361 where the two conflict; but nonrecognition of gain under § 337 from sales to outsiders (even though effected as part of the overall plan of reorganization) does not seem to be incompatible with the provisions of § 361, whose focus is on dealings between the transferor corporation and the acquiring corporation. Even so, however, the [Internal Revenue] Service * * * and the courts have so far denied use of § 337 to a corporation that is also subject to the jurisdiction of § 361. [Footnotes and citations omitted.]

B. BITTKER & J. EUSTICE, *supra*, ¶14.32 at 14–81. Here again, as authority for the last sentence, the authors cite several of the liquidation-reincorporation cases already discussed. Plaintiff's quote seems best explained as putting forward a personal view of the authors which they concede is not supported by authority. Plaintiff distinguishes these cases from the facts before us today, on the ground that each case involved an eventual transfer of assets between two corporations controlled by the same shareholders. In economic effect, the shareholders that possessed control over the assets at the outset maintained control at the end, even though title to the properties may have been transferred between their related corporations. On those facts, plaintiff concedes that it would be proper to disregard a purported liquidation as a sham, and recast the whole transaction as a reorganization under §§ 368(a)(1) (D) or (F), as the Tax Court did. Yet, the

same approach is inappropriate to its own reorganization under § 368(a)(1)(C), plaintiff reasons, because its shareholders relinquished control of the assets as title to them was transferred. Nor is there any suggestion here that any aspect of the transaction was a sham. Plaintiff concludes, therefore, that since it met the statutory requirements of § 337, it is entitled to benefit therefrom.

Plaintiff argues cogently, and the distinction it draws between the reincorporation situation and the present facts is well-taken. We agree with plaintiff that the holdings defendant cites do not control on their facts. We cannot base our decision in this case solely on their authority. Still, they furnish us some guidance, for they addressed just another aspect of the general problem before us now, how to distinguish a corporate reorganization from a liquidation. One characteristic common to these cases, as well as others where the courts examined a taxpayer's transaction for this purpose, is the either-or nature of the inquiry: the transaction is taxed *either* as a liquidation *or* a reorganization, never both. This also seems to have been our court's unstated premise in deciding *Mitchell* v. *United States*, 196 Ct. Cl. 694, 451 F. 2d 1395 (1971), and in *Ross Michael Simon Trust*, *supra*. Defendant's theory that these two types of transactions are conceptually incompatible aptly rationalizes the results both in *Mitchell* and the reincorporation cases. This is the core of this dispute; since defendant persuades us on this point, it must prevail.

As we see it, a corporate reorganization occurs where the owners of a business retain a proprietary interest in it as the enterprise continues under a modified corporate form. *Mitchell* v. *United States*, 196 Ct. Cl. at 699, 451 F. 2d at 1397, quoting Treas. Reg. § 1.368–1(b) (1955). Accordingly, the tax significance of plaintiff's receiving Whittaker Corporation common stock in exchange for its assets was to establish its continuity of interest in the business thereafter conducted by the Whittaker organization. As new stockholders in Whittaker, the former plaintiff's stockholders may not have been in control but we presume they shared in control to the extent their voting rights empowered them. The plaintiff states in its brief they soon sold most of their Whittaker stock. This

was not part of the plan, but the individual decisions of the stockholders. If, instead of accepting the stock, plaintiff had received cash or otherwise relinquished its proprietary stake in the business, the transaction would not have qualified as a reorganization for tax purposes. *Cf. Southwest Natural Gas Co.* v. *Commissioner*, 189 F. 2d 332 (5th Cir. 1951), *cert. denied* 342 U.S. 860. That form of transaction might possibly have constituted a liquidation, however, if plaintiff then distributed the cash received to its shareholders, inasmuch as a liquidation is analogous to the shareholders' selling their stock and receiving money in its place. *Pridemark, Inc.* v. *Commissioner*, 345 F. 2d 35, 41 (4th Cir. 1965). Thus, a complete liquidation, as the tax law knows it, involves either the dissolution of a business conducted in corporate form, or the planned disassociation of the shareholders from the business if the enterprise continues. *See* Treas. Reg. § 1.332–2(c) (1955). We note here, for future reference, that the definition focuses on the future conduct of the *business* enterprise rather than on any technical corporate procedure, such as dissolution under state law.

The facts of the present case leave no doubt that plaintiff's exchange of assets for stock was, as intended, a reorganization in purpose and effect. It seems obvious that the sale of a part of the corporate assets to outsiders, incident to larger transactions of other kinds, liquidates those assets but is not a "complete liquidation."

The Tax Court remarked in *Morley Cypress Trust*, 3 T.C. 84 (1944), that it knew of no rule requiring that an otherwise qualifying reorganization be disqualified because it occurred in the progress of a liquidation. *Id.* at 86. We have no quarrel with what the Tax Court said, for we, too, are unaware of any such rule as the one there repudiated. Our decision today confirms this, insofar as we hold that a reorganization occurring while plaintiff liquidated lost none of its vitality to control the tax consequences. We disagree, though, with plaintiff's contention that the Tax Court's statement contradicts our reasoning and we think that any differences are semantic. The term "complete liquidation" is a term of art in tax law, apart from its meaning in corporate law contexts. The same is true of the term "reorganization," defined for

Syllabus

tax purposes in § 368. Not every change in corporate form that might fall within the generic meaning of reorganization qualifies for tax treatment as such. Nor does every corporate dissolution under state law qualify as a complete liquidation for tax purposes; conversely, the tax law may recognize a liquidation even though the corporate form survives under state law. Treas. Reg. § 1.332–2(c) (1955). We think that the liquidation that the Tax Court referred to in *Morley Cypress Trust* was a liquidation under local law, which has no direct bearing on the tax consequences.

Accordingly, we grant defendant's motion for summary judgment on counts one and four, deny plaintiff's motion, and dismiss those counts of the petition.

---

548 F. 2d 340

## DON W. FINN v. THE UNITED STATES

[No. 323–75. Decided January 26, 1971. Plaintiff's motion for reconsideration denied April 29, 1977.]

ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Military pay; retired pay (disability) claim.**—Plaintiff, a former Naval aviator, sustained injuries when he ejected from his aircraft. In September 1971 a Physical Evaluation Board found plaintiff disabled at a 50% rate, and he was placed on the Temporary Disability Retirement List (TDRL). In November 1972 plaintiff was rated by the Veterans Administration with a 60% disability. In April 1975 after several medical examinations, a second Physical Evaluation Board found plaintiff 30% disabled and recommended permanent retirement. This recommendation was affirmed by a Physical Review Council, and in July 1975 the Secretary of the Navy ordered plaintiff's name removed from the TDRL and ordered that plaintiff be permamently retired with a 30% disability rating. Thereupon, plaintiff filed the present action requesting that his disability rating be changed to 60%. It is *held* that plaintiff has failed in his burden to show by cogent and convincing evidence that the Secretary acting arbitrarily or capriciously in permanently retiring plaintiff at a 30% disability or that the decision was unsupported by substantial evidence. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied and the petition is dismissed.

**Military pay; Court of Claims jurisdiction; retired pay (disability) claim.**

[1] In view of the discretion granted under 10 U.S.C. § 1201 to the various military departments to determine whether a member of the armed forces is fit for duty and, if not, the percentage of disability of the member, this court does not have power to review such determinations unless the petitioner shows by cogent and clearly convincing evidence that the determinations are arbitrary, capricious, or not supported by substantial evidence.

Armed Services ⇐ 104

**Military pay; correction of military records; decision of Board; substantial evidence.**

[2] The presence of some evidence by a plaintiff that he should be given a certain disability rating, even though provided by highly qualified physicians and highly credible, is not enough when opposing evidence is substantial.

Armed Services ⇐ 104

**Military pay; retired pay (disability); Veterans Administration Schedule for Rating Disabilities; evidence in Court of Claims.**

[3] Although the Veterans Administration's determination of a plaintiff's physical condition may be relevant evidence, it is not binding upon the court nor conclusive on the issue of disability retirement. This is especially true where the determination is based on a physical examination taken several years before the final examination by the particular military department involved.

Armed Services ⇐ 104

*Charles M. Munnecke*, attorney of record for plaintiff. *Thomas H. King*, of counsel.

*Robert M. Hollis*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

Plaintiff is a former Naval aviator who sustained multiple injuries when he made a high speed, low altitude ejection from his aircraft on February 17, 1970. The injuries included total knee dislocations and a fracture of the left shoulder. Plaintiff was hospitalized at the Naval hospital in Corpus Christi, Texas from February 16, 1970, until October 2, 1970, and again from March 23, 1971, until May 12, 1971. During

this period, plaintiff received three operations in an attempt to correct his injuries.

On October 2, 1970, a Naval Medical Board found plaintiff fit for limited duty for six months. This determination was reevaluated and affirmed by a subsequent board, which on May 21, 1971, found plaintiff again fit for only limited duty. A Physical Evaluation Board (PEB) found plaintiff to be disabled with a rating of 30 percent on July 23, 1971, based on the V.A. standard rating schedule for physical disabilities. This informal PEB also found plaintiff to be unfit for duty because of his disabilities.

A formal PEB hearing was held on September 8, 1971, as requested by plaintiff. This board recommended a 50 percent disability rating. After the filing of a rebuttal by plaintiff, the Physical Review Council (PRC) concurred with the formal PEB's finding of a 50 percent disability rating, and on December 23, 1971, plaintiff was placed on the Temporary Disability Retirement List (TDRL).

On November 11, 1972, plaintiff was rated by the Veterans' Administration with a 60 percent disability. Following this, plaintiff was examined twice by the Navy, in September 1973 and December 1974, to determine whether or not to retain him on the TDRL. After the December 1974 examination, an informal PEB convened on January 29, 1975, and reevaluated all of the conditions surrounding plaintiff's injuries and disabilities. This PEB found plaintiff to have a 30 percent disability and recommended that he be permanently retired. Plaintiff again requested a formal PEB, which was held on April 16, 1975. Plaintiff represented by counsel, introduced reports of private medical examinations that had been conducted to determine his condition, one by Dr. Bray and the other by Dr. Dickson. The formal PEB also found plaintiff to be 30 percent disabled and also recommended permanent retirement. This was affirmed by the PRC on June 19, 1975, and on July 18, 1975, the Secretary of the Navy ordered plaintiff's name removed from the TDRL and further ordered that plaintiff be permanently retired with a 30 percent disability rating.

On September 2, 1975, without having applied to the Board for the Correction of Naval Records, plaintiff filed this suit

demanding that his 30 percent disability rating be changed to a 60 percent rating. The case is before us on defendant's motion for summary judgment and plaintiff's cross-motion for summary judgment.

The Secretaries of the various military departments have been granted discretion to determine whether a member of the armed forces is fit for duty and, if not, what percentage of disability the member may have. 10 U.S.C. § 1201 (1970). In view of this discretion, this court has often described the applicable standard of review relative to military disability retirement:

> This court has held on many occasions that it has no power to review the decisions of the Secretary of one of the military departments or his authorized representatives in such a case unless the petitioner shows by cogent and clearly convincing evidence that such determinations are arbitrary, capricious, or not supported by substantial evidence. * * * [*Stephens* v. *United States*, 174 Ct. Cl. 365, 371–72, 358 F. 2d 951, 954 (1966).]

*See also*, *Unterberg* v. *United States*, 188 Ct. Cl. 994, 412 F. 2d 1341 (1969); *Merson* v. *United States*, 173 Ct. Cl. 92 (1965); *Furlong* v. *United States*, 153 Ct. Cl. 557 (1961); *Wales* v. *United States*, 132 Ct. Cl. 765, 130 F. Supp. 900 (1955). Thus, a determination by the Secretary that a plaintiff is entitled to a particular percentage disability or is fit for duty will not be overturned unless it was arbitrary or capricious or not supported by substantial evidence. Plaintiff here has failed to produce clear and convincing evidence to show that the military reviewing authorities' decisions were arbitrary or capricious or unsupported by substantial evidence. In fact, the only contrary evidence presented by plaintiff are the medical reports of two private physicians, Dr. Bray and Dr. Dickson. This court has repeatedly held that the presence of some evidence by a plaintiff that he should be given a certain disability rating, even though given by highly qualified physicians, is not enough when opposing evidence is substantial. *Cooper* v. *United States*, 178 Ct. Cl. 277 (1967); *Merson* v. *United States*, *supra*; *Boland* v. *United States*, 169 Ct. Cl. 145 (1965). A review of the administrative records before each of the Boards convened in this case shows that their decisions were based on substantial evidence. Furthermore, while the PEB of April 16, 1975,

Syllabus

considered plaintiff's private doctors' reports, it apparently placed more weight on the report of the Naval examination of Dr. Janovich. Dr. Janovich's examination report provides substantial evidence to support the PEB's final decision, and the contrary opinions of the other doctors, even if wholly credible, are insufficient by themselves to warrant this court to overturn the PEB's determination. *See Cooper* v. *United States*, *supra*, and *Merson* v. *United States*, *supra*.

Plaintiff asserts that the Navy was arbitrary or capricious in not following the VA's determination that plaintiff was entitled to at least a 60 percent disability. This, however, is an inadequate ground for this court to overturn the Navy's decisions. This court has stated that although the VA's determination of a plaintiff's condition may be relevant evidence, *Hutter* v. *United States*, 170 Ct. Cl. 517, 522–23, 345 F. 2d 828, 831 (1965), it is in no way binding upon the court nor conclusive on the issue of disability retirement. *Unterberg* v. *United States*, *supra; Merson* v. *United States*, *supra; Stephens* v. *United States*, *supra*. This is especially true in the instant case where the VA's determination was based on a physical examination that was taken two years before the Navy's final examination of the plaintiff.

Plaintiff has failed in his burden to show by cogent and convincing evidence that the Secretary of the Navy acted arbitrarily or capriciously in permanently retiring plaintiff at a 30 percent disability or that the Secretary's decision was unsupported by substantial evidence. Accordingly, the defendant's motion for summary judgment is granted, the cross-motion for summary judgment of plaintiff is denied, and the plaintiff's petition is dismissed.

---

548 F. 2d 928

## FIRST NATIONAL CITY BANK v. THE UNITED STATES

[No. 9–75. Decided January 26, 1977]

ON REHEARING EN BANC

**Contracts; Assignment of Claims Act; prohibition against assignment; subrogation; Government setoff rights; interest on judgment.**—On June 16, 1976 a majority of the panel which first heard

Syllabus

this case determined that plaintiff-bank was entitled to recover $54,369.37 free of defendant's setoffs, and remanded the case to the trial division on the issue of interest on the award. 210 Ct. Cl. 375, 537 F. 2d 426. Defendant moved for rehearing en banc, attacking the application of the no setoff provisions of the Assignment of Claims Act of 1940. As a result of consideration by the full court, the earlier panel decision is vacated and a new discussion and decision substituted. Franklin National Bank and the Small Business Administration advanced money to Trilon Research Corp., both lenders taking a lien on Trilon's right to Government contract payments on the contract here in issue. By contract completion defendant had made certain progress payments to Trilon and had paid Franklin certain sums. A year after contract completion plaintiff began making loans to financially troubled Trilon. The SBA advised Franklin that it had agreed to subordinate its one-half interest in Trilon's inventory and receivables to plaintiff. Subsequently, in an attempt to forestall Franklin from calling its loans to Trilon, plaintiff allowed Trilon to issue a $45,000 check payable to Franklin drawn on plaintiff, and Franklin and plaintiff entered into a refinancing arrangement whereby Franklin transferred to plaintiff its security interests in Trilon's receivables, and plaintiff paid Franklin $52,812 representing Franklin's remaining risk on the loan by releasing its priority rights to the $45,000 check and paying Franklin the balance of $7,812. However, Franklin refused to release its rights as assignee. Defendant sent to plaintiff but not to Franklin or SBA a copy of an agreement resolving a dispute over additional compensation due on the contract and also haggled with plaintiff over whether the latter should have priority before any government setoff. It is *held* that plaintiff does not belong within the class of assignees or of those "participating in such financing" under the 1940 Assignment of Claims Act, and has no rights under that statute. Plaintiff never became a proper reassignee because Franklin refused to release the prior assignment and on that ground the Government would not accept the attempted reassignment by Trilon to plaintiff. Also, the concept of those "participating in such financing" is confined to a lender whose loan was used, or was available for use, in financing the particular government contract under which suit is brought. Plaintiff's loan to Trilon was not used and was not available for the contract on which this suit is founded since the contract was fully performed about a year before plaintiff undertook to finance Trilon. It is also *held* that to the extent of the payments made by plaintiff to Franklin in 1971 plaintiff was subrogated to Franklin's rights under the latter's assignment from Trilon. Plaintiff is therefore allowed to recover that part of the monies it paid Franklin in 1971 which it has not yet recovered. It is also *held* that, since plaintiff has succeeded to Franklin's rights against defendant insofar as it has paid Franklin, such derivative rights are not obliterated by the

fact that plaintiff paid Franklin during the refinancing. Thus, if Franklin had a right to receive interest, plaintiff is entitled to recover interest. The case is remanded to the trial division to determine plaintiff's derivative entitlement to interest based on possible rights held by Franklin.

**Contracts; assignment of claims; prohibition against assignment; setoff protection, when available.**

[1] The phrase "participating in such [government contract] financing" appearing in the Assignment of Claims Act is confined to a financing institution whose loan was used, or was available for use, in financing the specific contract under which suit is brought. Thus, where plaintiff bank's loan to the contractor was not used and was not available for the particular contract sued upon because that contract was fully performed about a year before plaintiff undertook to finance the contractor by paying off the recognized assignee, and since plaintiff was aware, or should have been aware, that the contract was completed, plaintiff does not belong within the class of those "participating in such financing."

United States ⟸ 111(10)

**Contracts; assignment of claims; assignee's right to contract proceeds; setoff protection, when available.**

[2] The court's determination that plaintiff-bank has no claim under the Assignment of Claims Act to the right to recover free of setoff payments due under the particular contract which was fully performed before plaintiff's financing of the contractor, does not mean that loans must be tied to particular contracts nor does it go counter to the endorsement of the revolving-credit plan in *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 416 F. 2d 1296 (1969), since in all prior cases upholding the financing institutions' right to recover free of setoffs, the loans were made before completion of the particular contract sued upon and were available to help in performance of that work—even though the loans may not have been tied to, or designated as directed to, a or the specific contract.

United States ⟸ 111(10)

**Contracts; subrogation; generally.**

[3] As a general rule, subrogation applies where a party not acting voluntarily, but under some compulsion pays a debt or discharges an obligation for which another is primarily liable and which in equity and good conscience ought to be discharged by the latter. In such circumstances, the subrogee stands in the place of the original creditor and obtains equivalent but no greater rights against the debtor than held by the original creditor. Subrogation will be applied in favor of a party who acts to protect his own interests, and such a party is not ordinarily considered a volunteer and may be subrogated to the creditor's rights.

Subrogation ⟸ 33(2)

Syllabus

**Contracts; Assignment of Claims Act; generally.**

[4] The statutory purposes of the anti-assignment part of the Assignment of Claims Act are to prevent fraud, control multiple litigation, and confine the Government's dealings to a very limited number of persons or entities.

United States ⊜ 111(1)

**Contracts; subrogation; who is a subrogee.**

[5] Where plaintiff-bank CB in an attempt to forestall F, the legal holder of the right to receive the proceeds from the contract in suit, from calling its loans to contractor T, allowed T to pay F by check drawn on CB, and F and CB entered into a refinancing arrangement whereby F transferred to CB its security interests in T's receivables, including Government contract rights, in exchange for releasing the amount of the check upon which CB held a prior lien based on independent loans to T, CB did not pay T's debt as a volunteer but acted to protect its own interests in the prior loans made to T. Under these circumstances, and in view of the fact that the Government treated CB, rather than F or the Small Business Administration, as an interested party during setoff discussions and disputes over additional compensation due on the subject contract, plaintiff was subrogated to F's rights under the latter's assignment from T. In recognizing subrogation here, there is no contradiction of the aims of the original, historic anti-assignment law.

United States ⊜ 111(8)

**Interest; claims against the United States; when allowable.**

[6] Interest on a claim against the Government is not allowed absent a showing that plaintiff held a right to collect interest under a statute or contract so providing. 28 U.S.C. § 2516. Where the court has determined that plaintiff was subrogated to the original assignee's (F's) rights against defendant in the subject contract, if the evidence supports plaintiff's derivative entitlement to interest on the judgment based on rights held by F plaintiff is entitled to recover interest.

United States ⊜ 110

**Pleading and practice; summary judgment; when appropriate.**

[7] Where the evidence before the court is not meaningfully correlated to an ultimate issue in the case, summary judgment cannot be granted on such issue and a remand to the trial judge for further proceedings is required.

Courts ⊜ 470

*Joseph H. Levie*, attorney of record, for plaintiff. *Franklin N. Meyer*, of counsel.

*Stephen G. Anderson*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Leslie H. Wiesenfelder*, of counsel.

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*, *en banc*.

DAVIS, *Judge*, delivered the opinion of the court:

This case, before the court on cross-motions for summary judgment, was first heard by a panel. On June 16, 1976, a majority of the panel determined that plaintiff bank was entitled to recover $54,369.37 free of defendant's set-offs; the issue of interest on the award was remanded to the Trial Division. 210 Ct. Cl. 375, 537 F. 2d 426. The writer of the present opinion dissented in part, coming up with a result not too far in monetary terms from the majority's determination but rejecting the main basis of that decision—the no set-off provisions of the Assignment of Claims Act of 1940. The defendant moved for rehearing en banc attacking that foundation of the decision. Rehearing en banc was granted and the case has been orally reargued en banc. As a result of the consideration by the full court, we vacate the earlier panel decision and now substitute the following discussion and decision.

## I

### *Facts*

The genesis of the claim is found in a December 28, 1966, contract between Trilon Research Corp. (Trilon) and defendant. For a consideration of $87,318.46 Trilon agreed to prepare and update certain Navy technical manuals. On April 19, 1967, defendant made an initial progress payment under the contract to Trilon in the amount of $46,527.43.

The contract contained the usual financing and assignment clauses, incorporating by reference the provisions of the Armed Service Procurement Regulations (ASPRs), Paragraph 7-103.8 ASSIGNMENT OF CLAIMS (Feb. 1962), which in turn is based on the Assignment of Claims Act.[1]

Pursuant to these provisions, Trilon,[2] Franklin National Bank (Franklin), and the Small Business Administration (SBA) entered into a financing arrangement. Trilon obtained a loan of $250,000; $125,000 from Franklin and the

[1] 31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970).
[2] Through a subsidiary, P & D Electronics Co.

balance from the SBA. As collateral, Franklin and the SBA took a lien on Trilon's inventory and receivables. The lenders, with Franklin acting as trustee, also obtained an assignment of Trilon's right to Government contract payments, including but not limited to, the contract at issue in the present case.[3] Defendant received notice of Trilon's assignments on May 12, 1967. The parties completed the initial financing in July 1967.

By November 1968, Trilon had completed its work on the technical manual contract. In addition to the $46,527.43 progress payment already made to Trilon, defendant had further paid Franklin (as trustee) the remaining $40,791.03. However, "accord and satisfaction" was delayed due to a dispute concerning amounts Trilon had earned for extra work.

One year later, after Trilon had fully completed the manuals contract, plaintiff entered the scene by making loans to financially troubled Trilon. The initial loan was for more than $250,000. In September 1969, the SBA advised Franklin that it had agreed to subordinate its one-half interest in Trilon's inventory and receivables (including Trilon's Government contracts) to plaintiff. Subsequently, plaintiff loaned Trilon additional amounts and is now owed more than $400,000 by Trilon.

Still later, in September 1971, Franklin found itself in severe economic difficulty. Franklin "called" its loans to Trilon and threatened to call the SBA's loan. Attempting to forestall this action, Trilon issued a $45,000 check payable to Franklin and drawn on plaintiff. However, plaintiff held a prior right to the $45,000 based upon the independent loans to Trilon. To permit Trilon to continue work on its ongoing Government contracts, Franklin and plaintiff entered into a refinancing arrangement. Franklin transferred its security interests in Trilon's receivables (including Government contract rights) to plaintiff. Plaintiff paid Franklin $52,812.[4]

As a result of the refinancing, in November 1971, Trilon executed a second "notice of assignment" of the technical

[3] The primary purpose of Trilon's formation and the bulk of its operations were directed to Government contract work.

[4] The $52,812 represented Franklin's remaining risk on the $125,000 loan. To make the payment plaintiff released its priority rights to the $45,000 check and paid Franklin an additional $7,812 in cash.

manuals contract. Trilon assigned the payment rights to plaintiff. The notice was sent to defendant which remitted the documents to plaintiff to obtain a release of Trilon's prior assignment to Franklin. Such release was not obtained.

From late 1968 through 1971, the dispute over Trilon's entitlement to additional compensation on the technical manuals contract continued. Progress toward resolution finally began in February 1972, when the Contracting Officer (CO) ruled that Trilon had earned an additional $62,181.37. Trilon filed a notice of appeal, but the parties subsequently reached an agreement to adopt the CO's figure. Significantly, a copy of defendant's agreement to resolve the dispute was sent by the Government not to Franklin or the SBA but to plaintiff.

However, plaintiff and defendant failed to agree on plaintiff's right to receive the $62,181.37. Defendant claimed that it had sufficient set-offs [5] to obliterate plaintiff's entitlement to the award. Plaintiff countered that the technical manuals contract contained set-off protections enabling it to receive the $62,181.37, free of defendant's set-off claims.

On December 3, 1973, defendant submitted this question to the General Accounting Office (GAO). The Comptroller General held that plaintiff could recover $7,812 free of defendant's set-off claims.[6] However, the GAO disallowed the balance of the $62,181.37 on the basis that plaintiff was precluded from use of the set-off protections because it had not participated in the financing of the technical manuals contract. Since plaintiff had not extended funds toward the contract, reasoned the GAO, plaintiff could not assert the set-off protections contained in the Assignment of Claims

[5] At this time, Trilon owed the IRS $157,312.73 and was also indebted to the Government for unliquidated progress payments on an unrelated Government contract in the amount of $213,211.49.

[6] The GAO decision casts plaintiff's recovery in terms of "assignee-principal" or "beneficiary-principal." However, its reasoning appears to be based on a subrogation theory. According to the GAO, Franklin by virtue of the 1967 assignment was entitled to receive $125,000 from the Government or Trilon, without set-off. Franklin had received all but $7,812 of the $125,000 at the time of the refinancing. When plaintiff paid Franklin the $7,812 it stepped into Franklin's shoes and obtained the right to receive $7,812 in Government contract proceeds free of set-offs. The fact that Franklin had been paid the $7,812 did not void defendant's liability for this amount because defendant was a stranger to the refinancing and so far as the Government was concerned, still owed Franklin the $7,812.

Act and the ASPRs. Comp. Gen. Dec. B–180271 (Aug. 22, 1974).

Plaintiff then brought the instant action in its own name [7] to recover the $54,369.37 ($62,181.37 less $7,812) plus interest, disallowed by the GAO.[8]

## II

### *Assignment of Claims Act*

On rehearing, defendant's only point is that the set-off protections of the Assignment of Claims Act, 31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970), are not available to this plaintiff.[9] We therefore consider that problem first.

Trilon's technical manuals contract included by reference the standard financing and assignment provisions provided in the Armed Services Procurement Regulations (ASPRs). Drafted with an eye to the Assignment of Claims Act, the ASPRs permit assignment and reassignment in certain instances. They also grant set-off protection to assignees:

> [I]f this contract provides for payments aggregating $1,000 or more, claims for monies due or to become due the contractor from the Government under this contract may be assigned to a bank, trust company, or other financing institution, * * * and may thereafter be further assigned and reassigned to such institution. Any such assignment or reassignment shall cover all amounts payable under this contract and not already paid, and shall not be made to more than one party, except that any such assignment or reassignment may be made to one party as agent or trustee for two or more parties participating in such financing. Unless otherwise provided in this contract, *payments to an assignee of any monies due or to become due under this contract shall not, to the extent provided in said [Assignment of Claims] Act, as amended, be subject to reduction or set-off.* [ASPR ¶7–103.8 (1962) (emphasis added)].

[7] Neither the European-American Bank & Trust Co. (as purchaser of certain Franklin assets) nor the Federal Deposit Insurance Corp. (as transferee of other Franklin assets) appeared in this action, despite the issuance of Ct. Cl. Rule 41(a)(1) notices to appear as parties. In fact, the FDIC's response indicates that neither it nor Franklin has any such interest.

[8] Plaintiff's petition seeks $55,188 plus interest. However, this appears to be based upon an erroneous figure attributed to the CO's award and plaintiff's summary judgment brief revises the claim to $54,369.37.

[9] The defendant no longer argues that plaintiff has no standing at all to sue or that it is unable to recover in the capacity of Franklin's subrogee. *See* Part III of this opinion, *infra*.

This ASPR is based on the Assignment of Claims Act, 31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970). As a general rule, the Act prohibits assignments of claims against the Government. However, it is common ground that Congress has provided for certain assignments in order to encourage financing of Government contracts and has granted set-off protection rights to eligible assignees:

> The provisions of the preceding paragraph [invalidating assignments of claims against the Government] shall not apply in any case in which the moneys due or to become due from the United States * * * under a contract providing for payments aggregating $1,000 or more, are assigned to a bank, trust company, or other financing institution * * *: *Provided*,
>
> * * * * *
>
> 3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;
>
> * * * * *
>
> * * * [P]ayments to be made * * * to the assignee of any moneys due or to become due * * * shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States * * * which arises independently of such contract * * *. [31 U.S.C. § 203 (1970) and 41 U.S.C. § 15 (1970)].

It is these statutory provisions containing the set-off protection language, as incorporated into the technical manuals contract through the ASPR cited above, that plaintiff relies upon.

There are, however, two barriers to plaintiff's invocation of the Act. The first is that plaintiff was neither an assignee nor a reassignee under the statute or the contract clause. Franklin was, of course, the original assignee. First National City Bank never became a proper reassignee because Franklin refused (in 1971) to release its prior assignment and on that ground the Government would not accept the attempted reassignment to First National. If one thing is clear under

the statute and the clause, it is that, with respect to any individual contract, there can be only one assignee at a time (with the exception, to be discussed *infra*, of other parties "participating in such financing").[10] Since Franklin insisted on retaining its own assignment, plaintiff could not take over directly under the Act or the contract. Franklin alone remained the assignee and alone had the statutory rights of the assignee.

Even if it is not itself the assignee, plaintiff urges that it is and was a party "participating in such financing" under the provisions of the Act and the contract authorizing an assignment to be made "to one party as agent or trustee for two or more parties participating in such financing." Franklin, it is said, was and could be a trustee for First National because the latter participated in the general financing of Trilon's government contracts.

We reject this overly broad reading of "participating in such financing," and instead confine that concept to a lender whose loan was used, or was available for use, in financing the particular government contract under which suit is brought. Admittedly, the plaintiff's loan to Trilon was not used and was not available—and could not be—for the technical manuals contract on which this suit is founded since that agreement was fully performed about a year (1968) before First National City Bank even undertook to finance Trilon (1969).[11]

We reach this interpretation on both the text and the purpose of the statute.[12] The portion of the 1940 Assignment of Claims Act which permits assignment to financial institutions is entirely written in terms of a single government contract which is being financed by a lender or a group of

---

[10] The Act, *supra*, provides that any assignment permitted by the statute "shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing * * *." The ASPR clause, *supra* contains the same requirements which were imposed to prevent multiple claims on the same contract and to avoid multiplicity of actions. *See Consumers Ice Co. v. United States*, 201 Ct. Cl. 116, 119, 475 F. 2d 1161, 1163 (1973).

[11] First National had nothing to do with the technical manuals contract until September 1971 when it paid off Franklin, the recognized assignee.

[12] The pertinent ASPR and the contract clause do not deviate from the statute.

lenders—not in government-wide terms. The statutory concept is that of financing a specific government contract, not of the financing of government contracts in general or across-the-board, or the financing of all of a contractor's contracts as a lump. The immediate context of the phrase "participating in such financing" relates to the financing of the particular contract on which the statutory provision centers; grammatically and naturally, "such" refers back to the financing of that particular contract and "financing" likewise refers to the financing of that individual contract, not other contracts of the same contractor or contracts generally. It is, of course, too much of a strain to think of plaintiff as financing the technical manuals contract, all the work on which was done and finished a year before First National came into Trilon's world.

The objective of the 1940 Act was to authorize the financing of individual government contracts in the sense that Congress wished the holder of such a pact to be free to receive financial help in performing his agreement in reliance on the security of the expected government payments from that contract. At the same time Congress did not, we think, wish to eat into the Government's normal right of setoff against the assignor more than would be necessary to induce such monetary aid in performing. Where a contract has been fully completed, further aid is not needed for that contract and there is no occasion to give up the right of setoff.

This was the theory at the bottom of one of the court's holdings in *Coleman* v. *United States*, 158 Ct. Cl. 490 (1962). The question there was whether the contractor had actually received and used the funds to promote the completion of the contract before the court. Laying down its basic premise, the court said: "The Act was designed to make funds available to a contractor with which he could *complete his government contract*. If the loan is used for another purpose, the objectives of the Act are not satisfied." *Coleman* v. *United States*, *supra*, 158 Ct. Cl. at 496 (emphasis added). The court went on to absolve the lender if the contractor, after receiving the money, diverted it to other purposes instead of using it to advance performance of the contract. But it is crystal clear that in the court's view the assignment would be defeated if the lender had reason to know in advance that the loan pro-

ceeds could not be used in completing the contract. *See* 158 Ct. Cl. at 497. That is the situation here since there is no doubt that First National was aware, or at least should have been aware, that Trilon had already completed the technical manuals contract.

Plaintiff challenges *Coleman*,[13] but we think it was correctly reasoned and decided, and we adhere to its rationale and teaching.

This view does not mean that loans must be tied to particular contracts nor does it go counter to the endorsement of the revolving-credit plan in *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 416 F. 2d 1296 (1969). In all of our prior cases, including *Continental Bank*, which have upheld the financing institutions' right to recover free of setoffs, the loans were made before the completion of the particular contract and were available to help in the performance of that work—even though the loans may not have been tied to, or designated as directed to, a or the specific contract. The same is true of the "five-chambered house of horrors" plaintiff has included in its brief; with the exception of one-half of one of the five examples, in all those situations the loan is and can be available for all non-completed government contracts of that contractor-borrower, and therefore the financial institution can avail itself of the right of recovery free of setoff. It is only where the contract has been fully performed before the loan is made[14] that the institution cannot call upon that right under that particular contract. The reach of the rule is thus not nearly as wide as the plaintiff asserts. On the other hand, it should be noted that the plaintiff's broader view of the 1940 Act would allow a setoff-free recovery by plaintiff under the technical manuals contract even though First National had refused to pay Franklin off in 1971, and although the contract had been fully performed a decade before First National had any dealings with Trilon.[15]

---

[13] On the reargument, plaintiff's counsel conceded that *Coleman* could not properly be reconciled with his position.

[14] And perhaps where the loan agreement explicitly forbids use of the loan on a specific contract.

[15] Unfortunately, it is not unknown that claims under a contract take ten years or more to proceed through the administrative and judicial processes.

For these reasons, we hold that plaintiff does not belong within the class of assignees or of those "participating in such financing" under the 1940 Act, and has no rights under that statute.

## III

### *Subrogation*

Plaintiff also puts itself forward, apart from the 1940 Act, as the subrogee of Franklin which it paid off in 1971. To the extent of the payments made by plaintiff to Franklin at that time, we hold that First National was subrogated to Franklin's rights under the latter's assignment from Trilon.[16]

As a general rule, subrogation applies where a party not acting voluntarily, but under some compulsion pays a debt or discharges an obligation for which another is primarily liable and which in equity and good conscience ought to be discharged by the latter. *See, e.g., Compania Anonima Venezolana de Navegacion* v. *A. J. Perez Export Co.*, 303 F. 2d 692, 697 (5th Cir. 1962). In such circumstances, the subrogee "stands in the place" of the original creditor and obtains equivalent but no greater rights against the debtor than held by the original creditor. *United States* v. *Munsey Trust Co.*, 332 U.S. 234, 242 (1947).

It is true that a volunteer may not obtain subrogation rights; payment of the debt must result from some compulsion. *Prairie State Bank* v. *United States*, 164 U.S. 227, 231 (1896); *Aetna Life Ins. Co.* v. *Middleport*, 124 U.S. 534, 549 (1888); *Anderson* v. *United States*, 97 Ct. Cl. 545, 550 (1942). But subrogation will be applied in favor of parties who act to protect their own interests. One who pays another's debt to protect his own rights and interests is not ordinarily considered a volunteer and may be subrogated to the creditor's rights. *Federal Deposit Ins. Corp.* v. *American Surety Co.*, 39 F. Supp. 551 (W.D. Ky. 1941). *See also Nippolt* v. *Farmers' & Merchants' State Bank*, 186 Minn. 325, 243 N.W. 136 (1932) (bank agreeing to pay mortgage to protect other security interests held entitled to assignment of note and mortgage).

[16] The defendant no longer contests plaintiff's right as a subrogee to recover what it paid to Franklin free of setoff.

Clearly, under this principle plaintiff was no volunteer. It did not pay Trilon's debt as a volunteer but did so to protect its own interests in the prior loans made to Trilon. Both Franklin and Trilon faced severe economic difficulties in 1971. Franklin had called its loans to Trilon and had threatened to call the SBA's. If Franklin had persisted, Trilon might have been forced into receivership or bankruptcy, endangering plaintiff's loans to Trilon.[17]

It is no answer that to recognize subrogation here would subvert the limitations of the old anti-assignment part of the Assignment of Claims Act. On the facts, there is no contradiction of the aims of the original, historic anti-assignment law in allowing this plaintiff to recover as subrogee. The statutory purposes of that old legislation are to prevent fraud, control multiple litigation, and confine the government's dealings to a very limited number of persons or entities. *United States* v. *Shannon*, 342 U.S. 288, 291–92 (1952); *Consumers Ice Co.* v. *United States*, 201 Ct. Cl. 116, 119, 475 F. 2d 1161, 1163 (1973). In this particular instance, the Government, before the suit was brought, had already elected to deal with plaintiff with respect to the technical manuals contract. As we point out *supra*, defendant sent a copy of the agreement resolving the dispute (over additional compensation on the technical manuals contract) not to Franklin or the Small Business Administration but to plaintiff; the defendant also haggled with plaintiff over

[17] Defendant originally argued that plaintiff's release of the $45,000 check to Franklin (*see* Part I, *supra*) constituted a payment *by Trilon* to Franklin and Franklin was discharged to the extent of $45,000. To support this contention defendant cited the proposition that payment by a third party of a debt using funds of the debtor is equivalent to payment by the debtor, not the third party. *Krichbaum* v. *United States*, 138 F. Supp. 515, 518 (E.D. Tenn. 1956). The check was drawn by Trilon, payable to Franklin, with plaintiff as payor bank. According to defendant's earlier argument, plaintiff's release of the check (by paying Franklin the $45,000) was payment by a third party (plaintiff) of a debt (to Franklin) using the debtor's (Trilon's) funds. This contention ignored one crucial fact. Plaintiff held a prior claim to the $45,000 based upon its right of setoff:

"* * * [T]he right of a bank to a lien against money deposited with it and the right to set off a deposit against the depositor's indebtedness to the bank are part of the law merchant * * *." [*Kaufman* v. *First National Bank*, 493 F. 2d 1070, 1071 (5th Cir. 1974) (citation omitted)].

In short, plaintiff held the check subject to its right to set off the loans previously made to Trilon. Trilon could not demand that plaintiff pay this sum over to Franklin. When plaintiff paid the $45,000 it did so, in effect, not with Trilon's money but with its own.

whether the latter should have priority before any setoff; and the GAO appears in effect to have determined that First National was at least entitled to $7,812 without any setoff. Thus, by its own choice defendant treated First National as an interested party. Where that has happened it seems an unwholesome technical rigidity to apply the principles underlying the pre-1940 anti-assignment statute to lock the barn after the horse has deliberately been let out by the Government's own officials.

We therefore allow plaintiff to recover that part of the monies it paid to Franklin in 1971 which it has not yet recovered.

## IV

### *Interest*

Plaintiff also seeks recovery of accrued interest. Originally, defendant countered that if plaintiff's recovery is based on subrogation, we cannot award interest because Franklin's right to receive interest terminated at the time of the refinancing. However, neither plaintiff nor defendant has focused on the interest question in any detail in their arguments.[18]

We note first that, of course, plaintiff is not entitled to recover interest on a claim against the Government absent a showing that it held a right to collect interest under a statute or contract so providing. This requirement is based both on statutes and case law. 28 U.S.C. § 2516 provides:

> Interest on a claim against the United States shall be allowed in a judgment of the Court of Claims only under a contract or Act of Congress expressly providing for payment thereof.

*See also United States* v. *Mescalero Apache Tribe*, 207 Ct. Cl. 369, 518 F. 2d 1309 (1975), *cert. denied*, 425 U.S. 911 (1976).

In the instant case plaintiff has cited no statute or contract provision which would entitle it to interest on a judgment in its favor. Normally, we would be forced to deny such interest claims. However, defendant seems to concede that

[18] The issue was not mentioned on the reargument and both parties apparently accept the disposition of that point made by the panel decision (without dissent). We follow the panel disposition.

Franklin held a right to receive interest on the technical manuals contract proceeds. It says that such right terminated at the time of the refinancing. Unhappily, we do not have the specific provisions of the technical manuals contract before the court, other than those dealing with the assignments.

As discussed in Part III, *supra*, plaintiff has succeeded to Franklin's rights against defendant insofar as it has paid Franklin. Such derivative rights are not obliterated by the fact that plaintiff paid Franklin during the refinancing. Thus if Franklin held a right to receive interest, plaintiff would step into Franklin's shoes and would be entitled to recover interest in the present action. The only problem is that from the present state of the record we cannot ascertain Franklin's rights to obtain interest under the technical manuals contract. Where the evidence before the court is not meaningfully correlated to an ultimate issue in the case, summary judgment cannot be granted on such issue and a remand to the trial judge for further proceedings is required. *Cheyenne-Arapaho Tribes* v. *United States*, 206 Ct. Cl. 340, 353, 512 F. 2d 1390, 1397 (1975).

Accordingly, we must remand the issue of interest to the trial judge for a determination of plaintiff's derivative entitlement based on rights held by Franklin. Should it appear from additional evidence that Franklin could recover interest on the technical manuals contract proceeds, plaintiff will be entitled to receive interest on the amount it is entitled to recover as subrogee under Part III, *supra*.

CONCLUSION

Plaintiff's motion for summary judgment is granted in part (as provided in Part III, *supra*) and denied in part (as provided in Part II, *supra*). Conversely, defendant's cross-motion is denied in part and granted in part. The amount of recovery (including the interest issue) is remanded to the Trial Division for further proceedings under Rule 131(c) consistent with Parts III and IV of this opinion.

---

NICHOLS, *Judge*, dissenting:

Upon comparing the *en banc* court's opinion with the one written for the panel by Judge Kunzig, and now vacated, I

continue to think the latter was correct and should have been reaffirmed.

There is no disagreement that, after plaintiff paid Franklin off to avert Trilon's being thrown into bankruptcy and the further performance of its later contracts thus frustrated, plaintiff had equitable rights. While this court has no jurisdiction to entertain bills in equity, it may apply equitable doctrines in the adjudication of lawsuits, in the manner usual with American courts. We have the authority of Judge Madden that this includes suits by assignees under the Assignment of Claims Act to obtain contract payments free of set-off. *Chelsea Factors Inc.* v. *United States*, 149 Ct. Cl. 202, 181 F. Supp. 685 (1960). After being paid off in full, Franklin had no further enforceable rights as assignee. *Beaconwear Clothing Co.* v. *United States*, 174 Ct. Cl. 40, 355 F. 2d 583 (1966). I think First National City Bank could have gone into a Federal or state court, having equity jurisdiction, and obtained an order requiring Franklin to execute a reassignment in proper form. This is what I understood Judge Kunzig to imply in holding that First National was a "beneficiary," a term also used by Judge Madden. Though this was not actually done, we are not precluded from correcting the record to show it was done, because it should have been. 28 U.S.C. § 1491, as amended by Pub. L. 92–415, 86 Stat. 652. The effect of such a correction would have been that First National was a duly ordained re-assignee, a status fully recognized by the statute and the ASPR provision. It is not apparent to me in what way such a correction would frustrate the Assignment of Claims Act policy or violate any express provision thereof.

As to one not thus recognizable as an equitable re-assignee, the court's subrogation theory would be in my view somewhat of a misguided missile, opening up this court to a variety of possible claimants not within the Congressional policy. For example, a subrogee would not have to be a financial institution. One who is an equitable re-assignee does not need the subrogation theory to prevail.

If the same bank had been the assignee throughout, it could have invoked the no set-off provision with respect to

contract payments, although the funds advanced for performance of that contract has been repaid already. *Continental Bank & Trust Co.* v. *United States*, 189 Ct. Cl. 99, 416 F. 2d 1296 (1969). Thus the bank could maintain a continuing revolving credit financing device which did not attempt to link particular advances of money to contracts. I take it, the court ought to concede, if First National City Bank had become a proper formal re-assignee, it would have enjoyed all the rights of the original assignee. Thus, if the contract contained appropriate language, permitting re-assignment, it would not be necessary for the re-assignee, rather than the original assignee, to have advanced the funds used for performance of that contract, to recover the contract payments with offset protection. Nor would it matter if the contract was completely performed before the re-assignment took effect. The court uses some language about this which may be to the contrary. I am not sure whether the discussion of these matters is pointed solely at the situation the court has already found existed, that First National City Bank was not a proper re-assignee, or whether it is saying that even if it had been, it is still cut off a second time, at another pass. If this is the view the court means to take, I protest.

It seems obvious that re-assignment is sometimes going to be necessary. As happened here, banks may be in trouble and be obliged to reduce their commitments. They may reorganize, or merge. If occurrence of a re-assignment, no matter how formally perfect, frustrates the revolving credit arrangements we approved and protected in *Continental Bank & Trust Co.*, *supra*, the liberal intentions of the Congress, so often referred to in our opinions, are frustrated. The statute leaves the possibility of a re-assignment open, and the ASPR provides for it. It is not apparent how a re-assignment opens any floodgates or in anyway jeopardizes the restrictions Congress enacted to limit assignments as such. I do not see why we should take such a hostile position. If, however, we limit our holding to the actual situation of an incomplete or imperfect re-assignment, we leave it in the power of parties in the future to protect themselves by full performance of the formalities we deem so important. I think the imperfections here were correctible in equity, but

Syllabus

if the court thinks otherwise, and stops there, that is error but nowhere near so serious as the present opinion in its totality.

---

KUNZIG, *Judge*, dissenting:

I respectfully dissent from the majority opinion of the *en banc* court to the extent that it conflicts with the decision of the original panel. I therefore concur in Judge Nichols' dissent and adhere to my previous opinion. 210 Ct. Cl. 375, 537 F. 2d 426 (1976).

---

In accordance with the opinion of the court, a stipulation of the parties, and a memorandum report of the trial judge, it was ordered on May 6, 1977 that judgment for plaintiff be entered for $45,000.

---

548 F. 2d 939

## CHARLES B. BENENSON, ROBERT H. ARNOW, AND THE BENENSON CAPITAL COMPANY v. THE UNITED STATES

[No. 368-75. Decided January 26, 1977]

ON PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT ON THE ISSUE OF LIABILITY AND DEFENDANT'S OPPOSITION THERETO

**Eminent domain; taking; Pennsylvania Avenue Development Corporation Act of 1972; preservation and maintenance of historic sites.**—In September 1961 plaintiffs purchased the land and improvements located at 1401 Pennsylvania Avenue, N.W., Washington, D.C. (Square 225). The improvement is the Willard Hotel which plaintiffs leased back to the sellers for 99 years. In 1962 plans were commenced for creation of a "National Square" as a ceremonial gateway to the White House, involving demolition of the Willard Hotel and other structures on the Square. The opinion recites at length the various actions of Congress, the Pennsylvania Avenue Development Corporation, the Commission of Fine Arts, the District of Columbia, etc. which impeded plaintiffs' economical use of the building and barred them from demolishing the building and using the site for other purposes or from removing the facade to determine its structural safety for remodeling. In July 1968 the Willard ceased operations because the lessees were unable to expend the millions of dollars necessary to make the hotel viable and competitive, even if it were to continue to remain on the site, and they could not economi-

cally continue to operate the hotel and to pay rent. Plaintiffs seek to recover just compensation for the inverse condemnation of the hotel, and have moved for summary judgment on the issue of defendant's liability. For the reasons stated, plaintiffs' motion for summary judgment on all issues relating to defendant's liability, with the exception of the date of taking, is granted. At oral argument, defendant's counsel stated that if the court held that plaintiffs' property was taken, the Government would be willing to concede that the taking occurred on October 27, 1972, the date the Pennsylvania Avenue Development Act of 1972 became effective, and plaintiffs' counsel agreed to this date. The case is remanded to the trial judge to determine the amount plaintiffs are entitled to recover as just compensation and to determine, on the basis of a stipulation by the parties or evidence adduced by them, when plaintiffs' property was taken, provided that such date shall not be prior to October 27, 1972 nor later than August 14, 1976 when Congress amended the 1972 act.

**Eminent domain; taking; legislative or regulatory taking.**

[1] The Government's interference, by way of congressional enactments or implementing regulations, with an owner's use of his property may be so substantial, restrictive, and burdensome as to constitute a taking of the owner's property for which the Fifth Amendment mandates payment of just compensation.

Eminent Domain ⟸ 2(1)

**Eminent domain; taking; what constitutes.**

[2] While an ordinance or regulation enacted for the purpose of preserving and maintaining historic buildings and sites is a valid exercise of the police power, such action can constitute a taking for which just compensation is required, when the owner is deprived of all profitable uses of the property. Here, the actions of Congress in enacting the Pennsylvania Avenue Development Corporation Act of 1972, and amendments thereto, have impeded and restrained the owners of the historic Willard Hotel to the extent that it was not economically feasible to restore and operate the building as a hotel or other business property, and the owners have been barred from demolishing the building or removing the facade of the building in order to determine whether the structure permits profitable use for other purposes; even though the owners acted to sell the furniture and fixtures and this action, at the time taken, was in accordance with the Government's announced plans for the structure. Owners are not to be penalized for decisions regarding the development of their property when the Government's eventual wishes for that property are contrary to its previously announced plans and are unforeseeable.

Eminent Domain ⟸ 2(1)

Opinion of the Court

**Pleading and practice; summary judgment, motions for; affidavits; admissibility.**

[3] An affidavit of an expert real estate appraiser, presented in opposition to a motion for a summary judgment, whose relevancy rests entirely on assumptions in conflict with undisputed record evidence and with the actions of the parties during the years pertinent to the litigation, raises no triable issues.

Courts ⇐ 470

*J. Hampton Baumgartner, Jr.*, for plaintiff; *Stanley J. Fineman, Michael B. McGovern, Wilkes & Artis*, of counsel.

*Dorothy R. Burakreis* and *Hubert M. Crean*, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS, and BENNETT, *Judges*.

COWEN, *Chief Judge*, delivered the opinion of the court:

This is a suit to recover just compensation for the inverse condemnation of the historic Willard Hotel in Washington, D.C. Plaintiffs claim that the actions of the United States have so interfered with the use and enjoyment of their property as to constitute a complete taking of the fee interest, for which compensation is due under the Fifth Amendment. The facts essential to the disposition of the case on plaintiffs' motion are not in dispute. For reasons to be set forth, we agree with plaintiffs that a taking of their entire fee interest has occurred and remand the case to the trial division to determine the date of the taking and the amount of the compensation due plaintiffs.

I.

At all times pertinent to this case, plaintiffs have been the owners of the land and improvements located at 1401 Pennsylvania Avenue, N.W., Washington, D.C., on lot 32, square 225; the improvement is a large, vacant building known as the Willard Hotel, having frontage on Pennsylvania Avenue, N.W., 14th Street, N.W., and F Street, N.W. The record title to the land and improvements is held by Charles B. Benenson and Robert H. Arnow, as tenants in common, each having a 50 percent interest; The Benenson Capital Company is the owner of a beneficial interest in the land and improvements.

Plaintiffs purchased the Willard Hotel on September 29, 1961, for $3,000,000; simultaneously with this purchase, they leased the land back to the sellers for 99 years and the lessees continued operation of the Willard as a hotel until 1968.

Active Governmental involvement in the area encompassing the Willard Hotel (between the White House and the Capitol on the north side of Pennsylvania Avenue, N.W.) commenced in 1962, with the creation of the President's Advisory Council on Pennsylvania Avenue, which prepared a master plan in April 1964 for this area. This plan called for the demolition of the Willard and other structures in square 225 to make space for a "National Square," as a ceremonial gateway to the White House. The Advisory Council was replaced by the Temporary Commission on Pennsylvania Avenue (Commission) established by Presidential Order on March 25, 1965. The Commission's activities, limited in nature, were primarily to advise the President on aspects of implementing and coordinating the plan with the National Capital Planning Commission, proposing legislation, and promoting public understanding of the program for Pennsylvania Avenue and its objectives.

The Commission's first efforts were directed toward seeking legislation affording the Commission more permanent status and inducing the Secretary of the Interior to designate the Pennsylvania Avenue area as a national historic site. On September 30, 1965, pursuant to the authority of the National Historic Sites Act of 1935, 16 U.S.C. §§ 461, *et seq.*, Secretary of the Interior Udall signed an order of designation establishing the Pennsylvania Avenue National Historic Site. At that time, the Order contained a restriction that: "Unless provided otherwise by Act of Congress, no funds appropriated to the Department of the Interior shall be expended for the administration, protection and development of the Pennsylvania Avenue National Historic Site."

While this official designation did not bring the Government closer to ownership or administration of the area, the actual and intended effect of the designation was to create a Federal presence in the area, one which has continued and steadily grown to the present. The designation by the Department of the Interior was viewed as necessary to give

impetus to the announced plan for the avenue while congressional action on pending enabling legislation was awaited. In a memorandum dated June 21, 1965, to Secretary Udall, the Deputy Solicitor of the Department of the Interior explained the purposes and objectives of the order designating the Pennsylvania Avenue area as a national historic site as follows:

> Declaration of the Pennsylvania Avenue area as a National Historic Site can accomplish more than the initial objectives specified by Chairman Owings. The declaration, of itself in one action, establishes the *Federal presence over the area.* It provides the base from which specific planning and implementation may proceed.
>
> By virtue of the broad contractual authority (pages 8–9, *supra*), *necessary restraints on land use* may be imposed upon what might otherwise be haphazard [development] notwithstanding new development within the site while detailed planning goes forward and any necessary legislation is developed.
>
> Under the provisions of the act, for example, less than fee interests in lands may be acquired. (16 U.S.C. § 462(d)). This may be a method whereby undesired growth is checked. Contractual authority is, in this instance, backed by two powerful forces: *latent condemnation authority*, and moral-patriotic pressures. After immediate objectives are reached, the long-range necessity remains of maintaining the area in no less a condition than that which renders the completion of the entire plan feasible. A "*freeze*" can be effected on such development as would otherwise be inconsistent with the Plan. [Emphasis supplied.]

Through 1966, operation of the Willard by plaintiffs' tenant continued; nothing dramatic occurred with regard to the avenue plan. Little progress had been made by the Commission beyond securing designation of the avenue area as an historic site. Nevertheless, by the fall of 1967, plaintiffs were more interested in disposing of the Willard to the Commission than in investing further in a structure for which demolition loomed; the lessee, operator of the hotel, was also anxious for this resolution since the hotel was not profitable and defaults in the payment of rentals to plaintiffs were likely. On October 4, 1967, members of the Commission staff met with the Administrator of the General Services Ad-

ministration (GSA) and his deputy; the purpose of the meeting was to discuss ways of acquiring the Willard. The possibility of a trade for the Willard was mentioned.

As a result of this meeting, the Deputy Administrator of GSA submitted to plaintiff Benenson a list of surplus Federal properties which might be considered suitable for a trade. The Government only broached, at this point, the subject of acquiring the Willard by means of trade, since no funding was available for any other means of takeover. No direct discussion of eminent domain entered into these negotiations. The submission of the list was the first step in what was to become a long and sporadic series of negotiations between GSA and plaintiffs over a 5-year period. Despite repeated attempts, the parties were not able to come to terms and no trade resulted. Congressional opposition at various times during these years was an added barrier.

During the negotiations, the GSA felt that its efforts to acquire the Willard could only be justified if the property were to be turned over to the Department of the Interior for administration by the Park Service, pursuant to the National Historic Sites Act of 1935. This proposal, which would utilize the authority of GSA to trade surplus property, could be accomplished without action by Congress, since it involved no expenditure by the Park Service and required no appropriation. Therefore, the Commission wrote to the National Park Service to suggest that it formally request action by the GSA, as a means of validating the exchange negotiations.

In July 1968, the Willard Hotel ceased operations; the tenant was unable to pay for improvements that were necessary to make the hotel viable and competitive. Millions of dollars in capital expenditures would have been required to put the building in operating condition. Replacement of the heating plant, plumbing system, electrical wiring, the installation of new elevators, and the purchase of new room furnishings and furniture were some of the major items needed for competitive hotel operation. Occupancy at the hotel, and hence income, were very low. The lessee could not economically continue to operate the hotel and pay rent to plaintiffs. Consequently, the plaintiffs paid the lessee $250,000 for the remainder of the leasehold and cleared title to

the building. These events naturally stirred the Commission's hopes of acquiring the hotel and obtaining plaintiffs' cooperation in implementing the National Square project. Nonetheless, the Commission wished to press forward with an exchange lest the situation evolve to a point where plaintiffs might desire the development of the building and site in a manner inconsistent with the plan.

At the Commission's request, the Secretary of the Interior urged the Administrator of GSA to complete exchange negotiations for the Willard as soon as possible. His letter of October 24, 1968, stated in part:

> It is contemplated that the area bounded by Pennsylvania Avenue, F Street, 14th Street and 15th Street, which includes the Willard Hotel, will be developed as a National Square. Since the Willard Hotel has recently closed and is now available for the proposed project, *its acquisition at the earliest possible date is of crucial importance.* [Emphasis supplied.]

On the same day, October 24, 1968, the Secretary amended the Order of Designation for the Pennsylvania Avenue National Historic Site to enhance the likelihood of acquiring the Willard by removing the limitation on the authority of the Interior Department to use appropriated funds on the National Square plan. The formal request from the Secretary spurred on GSA; further delays in consummating a trade raised the spectre that plaintiffs might erect an expensive new building on the site, which, when the time for condemnation and demolition to make way for the Square finally came, would greatly increase the Government's costs of acquisition.

During this interlude of trade negotiations with GSA, between November 1969 and March 1970, plaintiffs sold all the furniture, fixtures and other personal property in the hotel at public auction. Plaintiffs knew that their operation of the Willard as a hotel would not be feasible. They were investors, not hoteliers. To leave the building vacant, with its valuable fixtures, ran the foolish risk of vandalism, a matter of much concern to the owners because of the disturbances which plagued the city in 1968. Moreover, a large-scale investment in a structure slated for razing seemed unsound to them. Prior to gutting the inside of the structure, plaintiffs had sought to make profitable use of the site. The

possibility of constructing an office building remained under consideration. Other business opportunities were explored. In 1968, plaintiffs attempted to lease the building to a hotel chain which would modernize and refurbish the premises. This deal collapsed when the plaintiffs were asked to guarantee that the property would not be condemned for a specified period of time. In the fall of 1969, the Inter-American Development Bank advised plaintiffs that it was interested in purchasing the Willard. The Director of the Bank informed plaintiffs that any such move would require GSA approval. Recognizing the conflict between the proposed purchase and the plan for a National Square, the GSA refused to permit the Bank to consider acquisition of the Willard.

On February 12, 1969, plaintiffs filed an application for a building permit to construct a new, income producing office building on the Willard site. The application was denied by the District of Columbia Department of Licenses and Inspections upon the recommendation of the District of Columbia Commission of Fine Arts, which found that the owners' building plans were inconsistent with the development of the Pennsylvania Avenue National Square proposal. Thereafter, following intervention by the owners, the office of Corporation Counsel for the District of Columbia rendered its opinion that the permit should have been issued. His opinion stated that the plan adopted by the Temporary Commission for Pennsylvania Avenue was without a statutory basis, because the plan had not been approved by the Zoning Commision and therefore "should not be afforded any validity in regulating land use."

The requested statutory basis for the plan proposed by the Commission was not provided by the 91st Congress, which failed to take action on resolutions introduced in January 1969. Moreover, in an act passed on October 15, 1969, Congress eliminated funds for the continuation of the Commission. Plaintiffs did not proceed at that time with their efforts to obtain a permit for the demolition of the building, because the chairman of the Commission assured them that the Pennsylvania Avenue plan would be implemented very soon by the Government's acquisition of the Willard for demolition. The

Commission's final report in 1969 retained the National Square plan, which had also been approved by the Commission of Fine Arts and the National Capital Planning Commission. In 1969 and 1970, plaintiffs also met, on several occasions, with Daniel P. Moynihan, then a presidential assistant, who repeatedly assured plaintiffs that a trade for the Willard should be worked out. Mr. Moynihan stated that he recognized that the owners of the Willard were being shabbily treated by continued delays.

Over the next 2½ years, efforts to complete an exchange for the Willard persisted, and legislation was sought which would establish a fully empowered corporation to implement the plan. The efforts to negotiate a trade for the hotel terminated when, on October 27, 1972, Congress enacted the Pennsylvania Avenue Development Corporation Act of 1972, Pub. L. 92-578, 40 U.S.C. §§ 871, *et seq.* The Act, as its name conveys, established the Pennsylvania Avenue Development Corporation (PADC) to prepare and effectuate a development plan for the area specified in the statute. The Willard was within the delineated region. The Act provided for an elaborate procedure of hearings and reviews to transpire before any plan recommended became effective. The last step in the approval process of a plan involved a 60-day review by both Houses of Congress. In order to implement the improved plan, the PADC was given a broad range of powers. In 40 U.S.C. § 875(6), the PADC was authorized to:

> * * * acquire lands, improvements, and properties within the development area by purchase, lease, donation or exchange; * * * hold, maintain, use, or operate such properties; * * * sell, lease, or otherwise dispose of such real and personal property and any interest therein as the Corporation deems necessary to carry out the development plan; or * * * lease, repurchase, or otherwise acquire and hold any property which the Corporation has theretofore * * * disposed of: *Provided*, That condemnation proceedings for the acquisition of real property (including interests therein), which may be necessary or appropriate in order to carry out the development plan, shall be conducted in accordance with the procedural provisions of chapter 13, subchapter IV, of title 16 of the District of Columbia Code.

However, before such powers could be exercised, further Congressional action was needed to authorize and appropriate funds for such purposes.

The 1972 act, 40 U.S.C. § 876, contained the following one-year moratorium provisions:

> (b) After October 27, 1972, no new construction (including substantial remodeling, conversion, rebuilding, enlargement, extension, or major structural improvement of existing buildings, but not including ordinary maintenance or remodeling or changes necessary to continue occupancy) shall be authorized or conducted within the development area except upon prior certification by the Corporation that the construction is, or may reasonably be expected to be, consistent with the carrying out of the development plan for the area: *Provided*, That if the development plan for the area does not become effective under the provisions of section 5 within twelve months of the date of enactment of this Act, this subsection shall be of no further force and effect until such time as the development plan does become effective under that section.

Early PADC expectations concerning a plan continued to envision a National Square and the demolition of the Willard. However, on October 26, 1973, the one-year moratorium on new construction contained in the Act expired because no development plan had become effective. Plaintiffs again applied to the District of Columbia government for a routine permit to demolish the nonstructural elements of the Willard in order that architects could examine the steel girders to determine whether the structural frame was suitable for the construction of a modern office building. The District of Columbia improperly submitted plaintiffs' application to the Commission of Fine Arts, purportedly seeking "appropriate action in accordance with the [Shipstead-Luce] Act." § 5–410, D.C. Code (1973), 40 U.S.C. § 121 (1970). In late November 1973, the Commission of Fine Arts returned the application to the District of Columbia government with the admonishment that the permit should not issue since removal of the exterior architectural features of the historic building was not in the public interest. The District of Columbia then denied the application.

The sentiments of the Commission of Fine Arts were soon to be shared by PADC; this emphasis on preservation of the Willard marked a complete about-face from Government plans dating back to 1962. Thus, while the first proposed PADC plan dated March 18, 1974, recognized the financial impracticality of maintaining the Willard and anticipated its demolition, the PADC plan of October 1974 called for continued existence of the Willard and its rehabilitation. The October 1974 plan became effective on May 19, 1975, after all statutory steps had been taken and Congress had acquiesced.

On December 21, 1973, plaintiffs, having been thwarted in obtaining the desired permit, filed suit in the Superior Court of the District of Columbia, cf. *Charles B. Benenson, et al.* v. *Commissioner of the District of Columbia, et al.*, Civ. Action 10837–73. On June 11, 1974, the Superior Court granted plaintiffs' motion for summary judgment and ordered the Mayor-Commissioner and the District of Columbia "to issue to plaintiffs the permit, applied for on October 26, 1973, to demolish the nonstructural elements of the Willard Hotel."

On October 1, 1974, Congress enacted Pub. L. 93–427, 88 Stat. 1170 which reinstated the moratorium provision that had been included in the 1972 act, 40 U.S.C. § 872(b). The 1974 statute, like its predecessor, provided that no conversion, remodeling, or major structural improvement of any existing building within the area covered by the PADC development plan could be conducted except upon prior certification by the PADC. This second moratorium was to expire on June 30, 1975, unless the development plan for the area became effective by that date. As previously stated, the Pennsylvania Avenue Development Plan became effective on May 19, 1975, and therefore, the law requiring prior approval of changes in the existing buildings remained in effect thereafter.

On December 10, 1974, the District of Columbia Court of Appeals unanimously affirmed the decision of the Superior Court, holding that the Shipstead-Luce Act, *supra*, did not give the Commission of Fine Arts the authority to consider applications for permits such as that filed by plaintiffs. *Commissioner of the District of Columbia* v. *Benenson*, 329 A. 2d 437 (D.C. App. 1974). The court also observed that "to deny the requested permit would raise the spectre of a taking with-

out due process of law." (329 A. 2d at 442.) On December 31, 1974, PADC entered that suit for the first time and joined in a petition for rehearing sought by the District of Columbia. The petition was denied February 20, 1975.

On December 16, 1974, shortly after the Court of Appeals had affirmed their right to the permit, plaintiffs were sued in the United States District Court for the District of Columbia by Don't Tear It Down, Inc. and Frank H. Rich. Also named as defendants were the Mayor-Commissioner and the Chief of the Permit Branch of the District of Columbia. The suit sought declaratory relief that the PADC Act (specifically the moratorium reinstated October 1, 1974), prohibited the District of Columbia from issuing the requested permit without prior approval of PADC. On December 27, 1974, PADC notified Mayor-Commissioner Walter Washington of its objections to the issuance of the permit, and on January 10, 1975, intervened as plaintiff in the action filed by Don't Tear It Down, Inc. On February 26, 1975, the District of Columbia notified the District Court that the PADC had requested that the permit not be issued, and therefore, that the Mayor and the Chief of the Permit Branch would decline to issue the permit until PADC certified that it be issued.

On August 26, 1975, the District Court enjoined plaintiffs from demolishing, converting, removing, or altering the exterior facade of the Willard without prior certification from PADC that such work was consistent with its development plan for the area. *Don't Tear It Down, Inc.* v. *Washington*, 399 F. Supp. 153 (D.D.C. 1975). The basis of the decision was the reenactment of the moratorium provision on October 1, 1974, which became permanent by reason of the fact that the PADC plan became effective May 19, 1975. The court found that the permit sought by plaintiffs was within the coverage of the Act and ruled that the "only activities excluded from this broad definition of new construction are ordinary maintenance or remodeling or changes necessary to continue occupancy." (399 F. Supp. at 156).

The injunction continues in effect. On September 23, 1975, the PADC formally rejected the request which the plaintiffs had made on October 23, 1973 to demolish the facade of the building.

On September 11, 1975, plaintiffs appealed the decision of the District Court to the United States Court of Appeals for the District of Columbia Circuit. Action on the appeal has been stayed by that court's order of October 29, 1976, pending our resolution of this suit.

After its plan became effective in May 1975, PADC promptly requested appropriations by Congress to implement the development plan. The President's budget for the fiscal year 1977 requested appropriations of $11.4 million for public improvements and $25 million in treasury borrowings. In explaining the proposed use of the requested funds, the Chairman of the PADC stated that the $25 million would be used during the first year for the acquisition of property and that the Willard had a high priority in these plans. Although a bill to authorize full funding of the plan was passed by the Senate and favorably reported by the House Committee on Interior and Insular Affairs, the legislation failed of passage in the House. However, on August 14, 1976, Congress amended the Pennsylvania Avenue Development Corporation Act of 1972 by authorizing appropriations for the operating and administrative expenses of the PADC until the fiscal year ending September 30, 1978, Pub. L. 94–388, 90 Stat. 1188. Public Law 94–388 authorized appropriations of $38.8 million for the implementation of the development plan. The Act was a confirmation of the PADC's restrictions, which prevented plaintiffs from making any reasonable use of the hotel, and contained the following express declaration by Congress that the Willard should be acquired by the PADC:

> * * * *Provided*, That appropriations made under the authority of this paragraph shall include sufficient funds to assure the development of square 225 as a demonstration area for the development plan, and shall assure the preservation of the structure now located on square 225 known as the Willard Hotel and its historic facade. * * *

However, no funds have actually been appropriated for the purchase or condemnation of the property and at the time this case was argued and submitted, there was no indication as to when or if Congress would provide the essential funds.

II.

The beginning point for resolving the legal issue presented by the foregoing facts is Justice Holmes' classic formulation in *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393 (1922):

> Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law. As long recognized, some values are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits. * * * One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not in all cases there must be an exercise of eminent domain and compensation to sustain the act. So the question depends upon the particular facts. The greatest weight is given to the judgment of the legislature but it always is open to interested parties to contend that the legislature has gone beyond its constitutional power. (at 413.)
>
> * * * * *
>
> The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking. (at 415.)

Subsequent decisions by the Supreme Court, by this court, and by other courts have reaffirmed the principle that the Government's interference with the owner's use of his property may be so substantial and burdensome that a constitutional taking is implied. *United States* v. *General Motors Corporation*, 323 U.S. 373 (1945); *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958); *Bydlon* v. *United States*, 146 Ct. Cl. 764, 175 F. Supp. 891 (1959); *Eyherabide* v. *United States*, 170 Ct. Cl. 598, 345 F. 2d 565 (1965); *Brown* v. *Tahoe Regional Planning Agency*, 385 F. Supp. 1128 (D. Nev. 1973), and *Keystone Associates* v. *State of New York*, 371 N.Y.S. 2d 814 (1975).

Beginning in 1972, when the act creating the PADC was passed and culminating on August 14, 1976, when Public Law 94–388 was enacted, the acts of the defendant have so impeded and restrained the plaintiffs as to deprive them of any reasonable use of their property. For many years, both the plaintiffs and the officials of the Government have rec-

ognized that it is not economically feasible to restore and operate the existing building as a hotel or other business property, but the defendant has barred the plaintiffs from demolishing the property and using the site for other purposes. The owners have also been enjoined from removing the facade of the building for the purpose of determining whether the structure of the building will permit a profitable use of the building for purposes other than the operation of a hotel.

The Willard has been under a cloud of condemnation at least from October 27, 1972, when the Pennsylvania Avenue Development Corporation Act of 1972 was passed, until the present time. The net effect of the acts of the Government is that plaintiffs cannot use their property for any income-producing purpose; they cannot sell it and thus far, the lack of Congressional appropriations has denied them compensation for it. Consequently, plaintiffs are forced to preserve the structure for the benefit of the Government, which bears no part of the financial responsibility. Since 1968, plaintiffs have been losing money on the property to the extent of $300,000 per year. There is essentially no dispute that at the present time and under existing circumstances, the property lacks a viable economic use and has in fact a negative market value.

The situation in which plaintiffs find themselves is substantially similar to that described by this court in *Drakes Bay Land Co.* v. *United States*, 191 Ct. Cl. 389, 411, 424 F. 2d 574, 586 (1970), in which we decried the harsh results which plagued an owner after Congress had specifically earmarked his property for acquisition by the Government:

> Thus plaintiff remains without a market for its land. The private sector is not interested, understandably, because of the well publicized threat of eventual condemnation of Seashore realty. The public sector, namely the National Park Service, is not interested because after having successfully thwarted plaintiff's subdivision plans, it realizes that plaintiff is a party who can be deferred interminably, and dealt with at pleasure. * * *

*See also Foster* v. *City of Detroit*, 254 F. Supp. 655 (E.D. Mich. 1966), *aff'd* 405 F. 2d 138 (6th Cir. 1968); *Halpert* v. *Udall*, concurring opinion, 231 F. Supp. 574 (S.D. Fla. 1964), *aff'd per curiam*, 379 U.S. 645 (1965); Van Alstyne, TAKING

OR DAMAGING BY POLICE POWER: THE SEARCH FOR INVERSE CONDEMNATION CRITERIA, 44 So. Cal. L. Rev. 1 (1971).

On the basis of the facts outlined above and the authorities cited, we conclude that the acts of the defendant, when considered in their totality, have so restricted and interfered with plaintiffs' use of their property as to constitute a complete taking of plaintiffs' fee interest therein, and that the taking occurred not later than August 14, 1976, when Congress enacted the amendment to the Pennsylvania Avenue Development Corporation Act of 1972.

III.

In its opposition to plaintiffs' motion, defendant has raised several defenses which we reject, because we find them contrary to the undisputed facts and unsupported by the authorities relied upon by the Government. We have also determined that the affidavit and accompanying material proffered by the defendant to defeat summary judgment for plaintiffs do not raise a substantial issue of fact which requires a trial.

A.

Defendant first contends that there has actually been very little interference with the use of plaintiffs' property as a result of the restriction imposed by PADC's denial of plaintiffs' request to remove the facade of the building. Defendant asserts that there are no other restraints on the use of the structure; that plaintiffs have complete freedom to alter the interior of the building for uses other than a hotel, and that the PADC has not prohibited the sale or other use of the property. In support of this argument, defendant has directed us to a line of cases which hold that a mere drop in property value as a result of a Government regulation is not *per se* a taking, and the fact that a regulation deprives the owner of the most profitable use thereof is not sufficient to entitle the owner to just compensation. These cases include *Goldblatt* v. *Town of Hempstead*, 369 U.S. 590 (1962); *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958) and *Maher* v. *City of New Orleans*, 516 F. 2d 1051 (5th Cir. 1975), *cert. denied*, 426 U.S. 905 (1976). We find

these and similar decisions relied on by defendant to be inapposite. In *Goldblatt*, the Supreme Court upheld an ordinance, which prevented mining below the water table, on the ground that there was no evidence which "even remotely suggests that the prohibition of further mining will reduce the value of the lot in question." (369 U.S. at 594.)

In *Central Eureka*, the court upheld a regulation which was issued for the purpose of conserving equipment and manpower for essential wartime uses. Although it recognized that a regulation can so diminish the value of property "as to constitute a taking," the court based its refusal to award plaintiff just compensation on the following:

> The reasons are plain. War, particularly in modern times, demands the strict regulation of nearly all resources. It makes demands which otherwise would be insufferable. (357 U.S. at 168.)

In *Maher*, the Fifth Circuit denied plaintiff's claim that a taking had occurred on the ground that he had not shown that "sale of the property was impracticable, that commercial rental could not provide a reasonable rate of return, or that other potential use of the property was foreclosed." (516 F. 2d at 1066.)

By contrast, the alleged potential uses of the Willard amount to no more than naked legal rights and for all practical purposes are completely unavailable to the owners. There can be no doubt in this case that there is no potentially profitable use of the Willard property that does not first proceed from the removal of the facade or the demolition of the entire structure. In its first Pennsylvania Avenue plan dated March 18, 1974, the PADC stated:

> Putting the Willard back into operation as a hotel would create a deficit of about $12 million. This assumes an estimated acquisition cost of $8 million for the Willard Hotel and the site adjoining it, along with an estimated rehabilitation cost of $15 million for the Hotel. Since the revenues generated by the Hotel and adjacent new construction could only support a total investment of $11 million it would be necessary for the Corporation to absorb the remaining $12 million of the cost of buying and fixing up the building. If the structure is converted to office use, the deficit would be about $11 million.

The National Trust for Historic Preservation commissioned a study entitled "The Willard Hotel Feasibility Study" which was dated October 1, 1974, and accompanied the plan PADC submitted to the Congress. It considered seven alternative uses of the Willard, leaving the facade intact. The first of these, assumed the use of the building as a hotel and showed that a capital expenditure of $19,875,000 would be required for renovation and that after this expenditure, the operation would result in a cash flow deficit of $505,580 per annum. Two office building alternatives showed project losses of $16,800,000 and $21,750,000. Two alternative proposals for use of the building as a condominium showed losses of $6 million and $14 million. An alternative which contemplated a mixed use of the property showed a project loss of $9,250,000.

Relying primarily on *Berman* v. *Parker*, 348 U.S. 26 (1954) and *Maher* v. *City of New Orleans*, *supra*, the defendant also argues that the restriction which prohibits plaintiffs from removing the facade of the Willard without the approval of the PADC as required by the Act of October 27, 1972, 40 U.S.C. § 876, is a valid exercise of the police power and does not give rise to a claim of taking and the recovery of just compensation. We do not question the now well recognized rule that an ordinance or regulation enacted for the purpose of preserving and maintaining historic buildings and sites is a valid exercise of the police power. It is equally incontestable that when a regulation becomes as extensive, restrictive and burdensome as we have found defendant's restrictions to be in this case, it constitutes a taking of the citizen's property for which the Fifth Amendment mandates the payment of just compensation. *Berman* v. *Parker; Bydlon* v. *United States* and *Brown* v. *Tahoe Regional Planning Agency*, *supra*. Unlike the facts in the cases cited by the defendant, plaintiffs have no beneficial or reasonable use of their property left to them. They are, in fact, forced by the PADC denial to maintain the Willard for the benefit of the populace at a cost of hundreds of thousands of dollars a year, with a complete loss of profits and with no certain and foreseeable relief.

B.

Defendant's second defense is that the lack of any feasible economic use of the Willard Hotel is due not to the regula-

tion issued by the defendant, but to plaintiffs' gutting of the building, plus years of deferred maintenance. Relying on an affidavit sworn to some 6 months after this suit was filed, defendant claims it is prepared to show at trial that if the plaintiffs had not gutted the hotel and had invested about $1,400,000 in maintenance, the property would now have a market value of about $20 million. Plaintiffs have aptly characterized this contention as one "made with the benefit of 20:20 hindsight * * * which strikes a false note," and totally ignores the situation that existed when the hotel was gutted. Nevertheless, since the case is before us on plaintiffs' motion for summary judgment, we accept the affidavit and accompanying material for what they purport it to be—the opinion of an expert prepared for this litigation and containing statements to which he would testify if a trial were held. At the same time, we hold, as a matter of law, that the affidavit is immaterial and raises no triable issue, because its relevancy rests entirely on erroneous assumptions made by the defendant. These assumptions are that the plaintiffs were guilty of negligence in failing to keep the property in condition as an operating hotel and in disposing of the personal property; that plaintiffs exercised poor business judgment; that their treatment of the property rather than defendant's restrictive acts caused the hardships and losses plaintiffs are now suffering, and that such treatment of the property is a legal bar to plaintiffs' right to recover just compensation.

We find that these assumptions are in conflict with the undisputed evidence of record before us as to the events that occurred and the actions of the parties in the years that are pertinent to this action. We also find that defendant's contention respecting the principles of law that apply to the facts is in error.

When the Willard Hotel was closed in July 1968 because of the serious financial difficulties of the lessee, it was the opinion of the manager, who had been in charge of the hotel from October 1966 to July 1968, that it would have cost a minimum of $4 million to $5 million to place the hotel in a competitive operating condition. It was also his opinion, expressed at that time, that the cloud of condemnation and the ultimate planned use of the property by the Government were

significant deterrents to further investment in the property. After plaintiffs, who were not hotel operators, were unsuccessful in leasing the hotel to a concern which would modernize and refurbish it, Mr. Benenson met with Nathaniel A. Owings, the Chairman of the Commission, during the summer of 1968 and was assured that the Pennsylvania Avenue Plan for the demolition of the building to make way for the National Square would be implemented very soon. Mr. Owings was upset when he heard that plaintiffs were exploring the possibility of demolishing the hotel and erecting a new building on the site. The Chairman urged Mr. Benenson to forget about his building plans since the Commission's plan for the National Square was a certainty.

At the request of the Government officials, plaintiffs agreed to cooperate with the Government in attempting to effect an exchange of the Willard for Government surplus property. Joe Moody, Deputy Administrator of GSA conducted most of these negotiations with Mr. Benenson. Mr. Moody sent Mr. Benenson a list of surplus properties for plaintiffs to consider in exchange for the Willard Hotel, and during the next 5 years, plaintiffs spent thousands of dollars in inspecting the properties which were located in many places in this country. The negotiations ended in 1972, just prior to the passage of the PADC Act.

On February 6, 1969, just 6 days before plaintiffs filed an application with the District of Columbia for a permit to construct a new office building on the site of the Willard, Chairman Owings of the Commission telegraphed Benenson as follows:

> I urge you not to seek legal action against the District as you continue your negotiation with GSA. We will do everything in our power to expedite the transaction. I urgently request a favorable reply.

It was not until August 15, 1969, that plaintiffs requested the permission of the Equitable Life Assurance Society of the United States, which held a mortgage on the Willard Hotel, to sell all removable furniture and fixtures. The furniture, fixtures and equipment were sold to the public between the months of November 1969 and March 1970. Thus it is undisputed by the record before us that before the furniture and

fixtures were sold, plaintiffs had been unable to find a lessee who would take over and operate the hotel, and that they were frequently urged by Government officials to do nothing with the hotel that would interfere with the then settled plan of the Government to acquire and demolish the hotel in order to make way for the Government structures to be erected in the new National Square. In view of all these circumstances, it can hardly be said that plaintiffs exercised poor business judgment or that they acted negligently in failing to make a large capital investment to keep the hotel operating. It was certainly in the Government's interest that plaintiffs not increase their capital investment in the Willard—otherwise the Government's cost of the proposed acquisition would have been increased.

Plaintiffs' fear that the valuable property and memorabilia in the building would be the subject of vandalism was a reasonable one in view of the civil disturbances which occurred in Washington, D.C. in 1968. When the public auction was held, no one could have predicted that the Government, some 6 years later, would completely reverse its plans and require the preservation rather than the demolition of the buildings in square 225.

In advancing its argument, defendant relies heavily on the example provided by the Washington Hotel which is also located in square 225 and was another of the buildings which were to be demolished under the Commission's plan for the National Square. In 1968, the Washington Hotel began a $1 million renovation and has successfully operated as a hotel from that time until the present. Apparently, it is the position of the defendant that plaintiffs should be penalized because they lacked the prophetic wisdom possessed by the owners of the Washington Hotel and failed to foresee that 6 years later, the Government would make a turn of 180 degrees in its plans for the buildings in square 225. Aside from the fact that the Washington Hotel is a family-owned business and is operated by persons with extensive experience as hoteliers, the action taken by the Washington Hotel in 1968 acts more to confirm than to detract from the business judgment of plaintiffs. Contrary to defendant's position in this action, the Washington Hotel's large investment in the

extensive renovation in 1968 was regarded by officers of the Commission as an act of folly. Their view of the matter at that time was correctly reflected in an article published in the A.I.A. Journal in December 1968. The article read in part:

> But in some quarters the Willard's swan song sounds like a promising overture. Viewing its demise as an important step toward the renewal of the nation's most historic avenue is Nathaniel A. Owings, FAIA, chairman of the President's Temporary Commission on Pennsylvania Avenue. For if the Willard is razed, the rest of the block between Pennsylvania Avenue, 14th, F and 15th Streets will likely follow suit and the commission's plan for a National Square become reality.
>
> * * * * *
>
> At present, the General Services Administration is trying to locate a suitable piece of government surplus land to exchange with the Willard's owners. Such an arrangement could be a catalyst and bring the rest of the $8-million block over on government hands.
>
> * * * * *
>
> Eliminated would be the Washington Hotel, now stubbornly undergoing a $1-million renovation, the Occidental restaurant "where statesmen dine" and two parking garages.

The legal conclusion which defendant would draw from its mistaken version of the facts is that since plaintiffs disposed of the furniture and fixtures and failed to invest a substantial sum in the maintenance of the Willard, plaintiffs are legally barred from claiming that their property was taken by the restrictive actions of the defendant which were authorized in a law that was not passed until several years after the public auction was held. Defendant has advanced no persuasive authority for this novel proposition. If that were the law, the Government could rely on an owner's treatment of his property many years prior to the issuance of a regulation or the passage of a statute as a defense to a claim of taking. Certainly, the case of *C. F. Lytle Co.* v. *Clark*, 491 F. 2d 834 (10th Cir. 1974), does not support defendant's argument. In that case a property owner obtained a building permit for the construction of 123 resort lodge condominium units. Two weeks thereafter, a zoning change was adopted

which deleted "lodges" from permitted uses. Nevertheless, the owner commenced construction of the lodge units and recorded a Condominium Map and Condominium Declaration which set aside the entire tract for the condominium resort lodges. After some 24 units had been completed, the owner had financial problems and construction ceased. Five years later, the owner filed an application for a building permit, stating that he wished to finish the work under the original permit. The application was denied, because the original building permit was no longer valid and the use of a permit to construct lodges was nonconforming. The result of the owner's filing and recording the Condominium Declaration was to preclude the use of the undeveloped land for any other purpose, notwithstanding the fact that there were other allowable uses under the zoning regulations then in effect. The court held that it was unnecessary for the owner to record the Condominium Declaration on all the units and for all the land before he had completed any of the construction and that as a result of his own voluntary acts, he had created the hardship confronting him. The court then concluded that there was no taking, because: "A landowner cannot create his own hardship and then require that zoning regulations be changed to meet that hardship." (491 F. 2d at 838.)

In this case, plaintiffs' closing of the hotel and the sale of the furniture and fixtures were not prohibited by any law or regulation then in effect. Plaintiffs do not claim that their property was taken by the Government prior to 1972, nor that they are entitled to recover on the basis that the Willard, at the time of the taking, was a profitably operating hotel having a market value of $20 million as estimated by defendant's expert. Unlike the owners in *Lytle*, plaintiffs did not act in defiance of a regulation or statute. On the contrary, the decisions which plaintiffs made and their treatment of the property in 1968 and 1969 were in no way contrary to the plans and policies which the Government had formulated more than 4 years before the furniture and fixtures were sold and which were then in effect.

We conclude, therefore, that defendant's argument regarding the principles of law that are applicable here is without merit.

IV.

For the reasons stated above, plaintiffs' motion for summary judgment on all issues relating to defendant's liability, with the exception of the date of taking, is granted and the case is remanded to the Trial Division to determine the amount plaintiffs are entitled to recover as just compensation. At oral argument, defendant's counsel stated that if the court held that plaintiffs' property was taken, the Government would be willing to concede that the taking occurred on October 27, 1972, the date the PADC Act became effective, and plaintiffs' counsel stated that he would also agree that the property was taken at that time. Accordingly, on remand the trial judge is authorized and directed to determine, on the basis of a stipulation by the parties or evidence adduced by them, when plaintiffs' property was taken, provided that such date shall not be prior to October 27, 1972 nor later than August 14, 1976.

---

DAVIS, *Judge*, concurring:

I join the court's opinion but wish to make it explicit that, for me, the possibility of a taking before August 14, 1976, depends on the correctness of the position announced by Chief Judge Jones in *Don't Tear It Down, Inc.* v. *Washington*, 399 F. Supp. 153 (D.D.C. 1975), now on appeal to the U.S. Court of Appeals for the D.C. Circuit, that under the congressional legislation the owners could not demolish the Willard or change the facade during the moratoria (without permission of the Pennsylvania Avenue Development Corporation). I accept and agree with Judge Jones' ruling. But if it should finally and authoritatively turn out that that position is incorrect, either because such alterations were permissible under the statute even during the moratoria (*see* 399 F. Supp. at 155–56) or because the owners obtained—during the period from October 26, 1973, to October 1, 1974, when there was no moratorium—a vested and continuing right to demolish (*see* 399 F. Supp. at 156–57), then I believe that the taking date would have to be August 14, 1976. I do not at all expect that there will be a final and authoritative decision in conflict with the position of *Don't Tear It*

Syllabus

*Down, Inc., supra*,[1] but I place this caveat on the record because it is essential to my thinking with respect to a pre-August 1976 date-of-taking that the owners could not alter the facade or other non-structural elements of the Willard during the moratoria contemplated by Congress in the Pennsylvania Avenue Development Corporation Act of October 27, 1972.

---

549 F. 2d 740

## BASIC INCORPORATED v. THE UNITED STATES

[No. 55–72. Decided January 26, 1977. Plaintiff's motion for rehearing or to alter judgment denied April 1, 1977.]

ON THE PROOFS

**Taxes; income tax; inter-corporate distribution v. transfer of stock for purpose of sale.**—In November 1964 Falls Industries Incorporated (Falls), a wholly-owned subsidiary of plaintiff-taxpayer (Pasic), distributed to Basic ownership of all the outstanding stock that Falls held in Basic Carbon Corporation (Carbon). On December 29, 1964 Basic sold the stock of Falls and Carbon to The Carborundum Company, an unrelated third party, pursuant to a then-outstanding offer to purchase. In its 1964 federal income tax return Basic reported dividend income from Falls in an amount representing Falls' basis in the Carbon stock, and claimed a dividends-received deduction with respect to 85% of this amount pursuant to Sec. 243(a)(1) of the Code, and also reported a long-term capital gain of $2,310,217.52 from the sale to Carborundum of the shares of Falls and Carbon. The amount of tax shown due in the return was timely paid by Basic. Upon audit the Internal Revenue Service determined that the gain reported by Basic from the sale to Carborundum should be increased by $501,869.76 and that the dividend income reported by Basic should be reduced by an equivalent amount. An additional income tax plus interest thereon was assessed against Basic and paid. Upon disallowance of its refund claim, Basic filed the present action. In view of the circumstances of this case, it is *held* that the transfer of Carbon's stock by Falls to its parent company Basic was not an inter-corporate dividend having independent business significance, but the transfer was an integral step in a transaction whereby Basic, by reason of the "cost-free" basis in the transferred stock under Sec. 243(a)(1) sought to reduce the total gain realized by it in its subsequent disposition of the stock of Falls and Carbon to Carborundum. Plaintiff is not entitled to recover and the petition is dismissed.

---

[1] The Court of Appeals, after counsel had appeared for oral argument, stayed action on the appeal in that case pending resolution of the present action.

Per Curiam

**Taxes; statutes; construction and operation; form v. substance of transaction.**

[1] In matters of taxation it is the substance of a transaction that determines its tax consequences rather than the form or timing with which it has been carried out. If a taxpayer enters into a transaction that has no business or corporate purpose and that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it.

Internal Revenue ⇐ 236

**Taxes; income tax; corporate distributions and adjustments; inter-corporate dividend v. transfer of stock for purpose of sale.**

[2] Where taxpayer's wholly-owned subsidiary F (whose business interests were distinct from those of taxpayer B), distributed to B all of F's outstanding stock which it held in B's second-tier subsidiary C, and immediately thereafter B sold the stock of F and C to an unrelated third party pursuant to a then-outstanding offer to purchase, the transfer by F of C's stock to B cannot be considered an inter-corporate dividend distribution within the meaning of Sec. 243(a)(1) of the Code allowing for an essentially tax-free transfer of C's stock from F to B, where B has shown no reason for the transfer of C's stock from F to B aside from the tax consequence attributable to that move. Instead, the transfer was simply an integral step in a unified sale transaction wherein no business interest was served and amounted to an attempt to reduce the tax that B would otherwise have incurred in the sale of its own property, i.e. the shares of F.

Internal Revenue ⇐ 752

*Henry C. Harvey*, attorney of record, for plaintiff. *Jones, Day, Reavis & Pogue*, of counsel.

*Theodore D. Peyser*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Donald H. Olson* and *William Kalish*, of counsel.

---

Before SKELTON, NICHOLS, and KUNZIG, *Judges*.

---

OPINION

PER CURIAM: This case comes before the court on plaintiff's and defendant's exceptions to the recommended decision of Trial Judge John P. Wiese, filed December 15, 1975, pursuant to Rule 134(h), having been submitted to the court on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recom-

mended decision, as modified, it hereby affirms and adopts the same as the basis for its decision in this case.* It is therefore concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

WIESE, *Trial Judge:* On November 24, 1964, a wholly owned subsidiary distributed to its parent corporation, plaintiff here, ownership of all the outstanding stock that it held in plaintiff's second-tier subsidiary. Immediately after this transfer, plaintiff sold the stock of both subsidiaries to an unrelated third party pursuant to a then-outstanding offer to purchase. The question that is raised in the case is whether the transfer of stock to plaintiff should be treated as an intercorporate dividend, a characterization which would here allow for an essentially tax-free transfer of basis to Basic, or, following the Government's position, is a transfer to be ignored for tax purposes, thereby yielding an increase in the capital gain which plaintiff realized from its sale of the stock of the two companies. The conclusion reached is that, for tax purposes, the dividend is to be disregarded and that plaintiff's gain on the sale should be increased by the corresponding amount.

I. *Facts***

A. Plaintiff, Basic Incorporated (hereinafter Basic), is an Ohio corporation whose principal business involves the production and sale of basic refractory materials for use largely in steel-making furnaces. In May of 1963, Falls Industries Incorporated (hereinafter Falls), became a wholly owned subsidiary of Basic through a merger carried out by an exchange of Basic's cumulative convertible preference shares for the outstanding shares of Falls. At the time of this acquisition, Falls was engaged in the manufacture and sale of processing equipment made wholly or in part from impervious graphite and certain specialized carbon and graphite

*The dissenting opinion of NICHOLS, *Judge,* follows the opinion of the trial judge which has been adopted by the court.

**The facts that are noted at this point repeat, for the most part, the separate Findings of Fact which accompany the opinion.

formulations. This business was conducted at two plants, one located in Solon, Ohio; the other in Sanborn, New York.

On January 1, 1964, Falls transferred its Sanborn plant and related assets, having an adjusted basis of $501,869.75, to a then newly organized New York corporation called Basic Carbon Corporation (hereinafter Carbon). In return for this transfer of assets, Falls received all the stock of Carbon. Thus, as of January 1, 1964, Basic owned all the outstanding stock of Falls and Falls, in turn, owned all of the outstanding stock of Carbon. This configuration, expressed in more traditional terms, identified Basic as the parent corporation, Falls as the first-tier subsidiary, and Carbon as the second-tier subsidiary.

In August 1964, discussions were initiated between Basic and The Carborundum Company of Niagara Falls, New York (hereinafter also Carborundum), concerning possible business transactions between the two companies. Initially, these discussions focused only upon a merger between the two companies. However, by early October 1964, the discussions had also come to include the possibility of a partnership between Basic and Carborundum that would jointly expand the carbon and graphite business of Falls and Carbon as well as the possibility of a sale of this business to Carborundum. By the end of October, Basic had decided against the merger route and it had also come to realize that it could not afford the simultaneous capital outlays that would be required for the continuous development of its basic refractory business on the one hand and the costs involved in going forward with the intended expansion of the carbon and graphite business on the other. Accordingly, sale of the carbon and graphite business became the choice that Basic determined it would follow.

Subsequently, on November 6, 1964, at a meeting of the corporate officers of Basic and Carborundum, a purchase price for the carbon and graphite business was tentatively agreed upon between the respective board chairmen of the two companies. The price was tentatively set at $3,935,000 plus an assurance from the buyer, Carborundum, guaranteeing the repayment to Basic of $1,000,000 which that company had previously advanced to Carbon. However, as to the

details of the transaction, including the form in which it would be carried out, these were left for later negotiation.

In the course of the further negotiations that followed, Carborundum first proposed that it purchase all the assets of Falls and Carbon. To this Basic responded that the tentative price would have to be increased by $265,000 in order to allow for various tax and management considerations. Additionally, Basic demanded that Carborundum also agree to indemnify Basic for any further tax assessments that might become payable on the transaction in excess of those which Basic could anticipate and compute in advance. These considerations were unacceptable to Carborundum.

Inasmuch as Carborundum was chiefly interested in acquiring the assets of Falls and Carbon, it next proposed that it purchase from Basic, directly, the Falls stock and the Carbon stock. Its purpose in making this second proposal was to enable it to buy the stock of both companies for cash, to thereafter liquidate the companies so as to thereby acquire their assets and then to allocate the aggregate purchase price to the respective assets.

This second proposal was made by Carborundum because it was seen by that company to be in its own best interests; the proposal was not made by that company for the purpose of specifically granting Basic any tax advantages that might not otherwise result were the transaction to be cast in a different form. In a report to the board of directors of Carborundum, dated November 17, 1964, it was explained that, while Carborundum would have preferred to purchase assets only, it remained advantageous for Carborundum to purchase the stock of Falls and the stock of Carbon directly from Basic and that Basic would, therefore, be requested to transfer the ownership of Carbon from Falls to Basic prior to the transaction.

Basic, for its part, considered the tax consequences of the proposed transaction as well as the alternative approaches that might be taken. It found the second proposal to be satisfactory.

On November 23, 1964, Carborundum submitted a formal offer to Basic conforming with the terms previously discussed. Thus, the offer proposed to: (a) purchase from Basic

all the stock of Falls and all the stock of Carbon for $3,935,000; (b) buy, or cause to be paid, the $1,000,000 debt of Carbon to Basic; (c) reimburse Basic up to $100,000 for advances to be made to Falls and Carbon between October 31, 1964, and the transaction closing date; and (d) purchase at Basic's cost all its rights to acquire certain properties then being acquired by Basic. This offer provided for a closing date of December 31, 1964, or such other date as might be agreed upon. The offer was irrevocable, by its own terms, until November 27, 1964.

On November 24, 1964, one day after Carborundum had made its formal offer to Basic, a special meeting of the board of directors of Falls was held. At this meeting, which was attended by a quorum of Falls' directors, it was reported that the company's sole shareholder, Basic, had been discussing with The Carborundum Company the sale to Carborundum of the shares of Falls' wholly owned subsidiary, Carbon. It was also reported that Carborundum was insisting that it purchase these shares from Basic rather than from Falls directly. Accordingly, at this same meeting, the chairman of the board of Basic, who, as it happened was also a director of Falls,[1] recommended that Falls distribute the stock of its wholly owned subsidiary, Carbon, to Basic as a dividend so as to enable Basic to thereby deal separately with the stock of Carbon and the stock of Falls. After discussion, a resolution to such effect was passed and the stock of Carbon was transferred to Basic the same day. By means of this unilateral transfer, Basic became the legal owner of record of all the outstanding shares of Carbon stock.[2]

[1] The meeting was attended by three of Falls' directors. Of these three, two—a Mr. Eells and a Mr. Ludwig—held positions of comparable responsibility in Basic. Mr. Eells was chairman of the board of Basic and it was he who, together with his counterpart in Carborundum, had established the tentative purchase price; Mr. Ludwig was the financial vice-president of Basic and it was he who had participated in the followup negotiations that led eventually to the second Carborundum offer.

[2] Aside from this stock transfer, the only other dividend distribution made by Falls during the period of Basic's ownership was a cash dividend of $275,000 that Falls had declared on November 5, 1964. The purpose of this November 5th dividend, which had been made payable on December 31, 1964, was to reimburse Basic for the cash dividends that it had paid and would continue to pay through December 1964 on the convertible preferred stock that it had issued at the time of its merger with Falls in May 1963.

One day later, November 25, 1964, the board of directors of Basic authorized the acceptance of the terms and conditions specified in Carborundum's formal offer and the offer was so accepted on the same day. On December 29, 1964, the sale and transfer of all the stock of Falls and Carbon by Basic to Carborundum was completed in accordance with the terms of the agreement.[3]

B. In its federal income tax return for calendar year 1964, Basic reported dividend income from Falls in the amount of $501,869.76 as a result of its receipt of the stock of Carbon. Also, it claimed a dividends-received deduction with respect to 85 percent of this amount pursuant to Section 243(a)(1) of the Internal Revenue Code of 1954 [4] and it reported a long-term capital gain of $2,310,217.52 from the sale to Carborundum of the shares of Falls and Carbon. The amount of tax shown due in the return was timely paid by Basic.

During 1970, the IRS concluded an examination of Basic's federal income tax return for 1964 and determined that the reported gain from the sale of the shares of Falls and Carbon should be increased by $501,869.76 and that the reported dividend income should be reduced by the corresponding amount. As a result of this determination, and other adjustments to Basic's return for 1964 which are not in controversy, additional income tax of $68,818.12, plus interest, was assessed against Basic. This additional amount has been paid. On November 3, 1970, after the execution of appropriate agreements extending the limitations period for assessment of Basic's income taxes for 1964, Basic filed a claim for refund of $87,827.22 on the ground that its treatment of the Carbon stock as a dividend was correct. On August 11, 1971, the refund claim was disallowed and on February 14, 1972, the present action was brought.

## II. *Discussion*

In matters of taxation, the point is often made that it is the substance of a transaction that determines its tax conse-

[3] The initial purchase price of $3,935,000 was adjusted downward by $25,000 in compromise of an accounting issue that developed following the offer-specified examination of the books and records of Falls and Carbon. This matter is immaterial to the issue presented in this case.

[4] Other references in this opinion to code sections shall be understood to refer to the Internal Revenue Code of 1954, as amended, and in force during 1964, the tax year involved in this suit.

quences rather than the form or timing with which it has been carried out. This doctrine or rule is a corollary of the fundamental principle of statutory construction that a transaction or event, even though falling within the literal terms of a statute, may yet be outside its spirit or purpose and thus be outside its intended scope.

The "substance-over-form" doctrine is commonly attributed to the decision in *Gregory* v. *Helvering*, 293 U.S. 465 (1935), a case in which the absence of a business purpose made literal compliance with the statutory provisions for a spin-off reorganization insufficient to accomplish what would otherwise have qualified as a tax free transfer. The taxpayer in *Gregory* had caused her wholly owned corporation to transfer certain property (shares of another corporation) to a newly formed corporation which the taxpayer also owned. Shortly after this transfer, the new corporation was liquidated and its property was distributed to the taxpayer. Immediately thereafter, the taxpayer sold the shares that had been distributed in the liquidation. The only tax that was reported in this transaction was the capital gain realized on the sale after distribution. The Government challenged this tax treatment claiming that, in actuality, the intermediate transfer of the shares between the two corporations was not, as the taxpayer contended, a tax-free reorganization, but simply a means used to accomplish the distribution of a dividend.

In its decision, the Court acknowledged that a valid corporate entity had been created and that the transaction fit within the literal requirements of the statute. Nevertheless, in upholding the Government's position, it went on to say that:

> When subdivision (B) [of Section 112 of the Revenue Act of 1928] speaks of a transfer of assets by one corporation to another, it means a transfer made "in pursuance of a plan of reorganization" * * * of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case here. [*Gregory* v. *Helvering*, *supra*, 293 U.S. at 469.]

The Court saw the facts before it as "[s]imply an operation having no business or corporate purpose—a mere device

which put on the form of a corporate reorganization * * * not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner." (293 U.S. at 469.) Such a situation, held the Court, "lies outside the plain intent of the statute." (293 U.S. at 470.)

Although *Gregory* was concerned with a corporate reorganization question, the rationale of that case has not been confined in application to such situations alone. Rather, that decision, as Judge Learned Hand explained in *Commissioner* v. *Transport Trading & Terminal Corp.*, 176 F. 2d 570, 572 (2d Cir. 1949), has come to stand for the proposition "that in construing words of a tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." An even more incisive formulation of the same thought was later expressed—again by Judge Hand—in *Gilbert* v. *Commissioner*, 248 F. 2d 399, 411 (2d Cir. 1957) (dissenting opinion), in these words:

> * * * The Income Tax Act imposes liabilities upon taxpayers based upon their financial transactions, and it is of course true that the payment of the tax is itself a financial transaction. *If, however, the taxpayer enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it;* for we cannot suppose that it was part of the purpose of the act to provide an escape from the liabilities that it sought to impose [emphasis added].

With the foregoing in mind,[5] we come then to consider the case at hand. That the stock distribution in issue fit the literal requirements of a dividend is not a point of debate—the transfer of the Carbon shares from Falls to Basic clearly met the specifications of Section 316(a)(1) which defines the term "dividend" as "any distribution of property made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913." Rather, the point of concern here is the tax implications that follow from the dividend characterization. Not only would this provide Basic with the advantage of a transferred basis in the Carbon

[5] The *Gilbert* formulation quoted in the text above was later adopted by the Supreme Court in *Knetsch* v. *United States*, 364 U.S. 361, 366 (1960).

stock (*i.e.*, the same basis which Falls held in that stock—Section 301(d)(3)), but, more importantly, Basic would obtain this transferred basis essentially tax free by virtue of the deduction from income allowed inter-corporate dividends under Section 243(a)(1). In net effect, then, the "cost-free" basis in the transferred stock would go to reduce the total gain realized by Basic in its subsequent disposition of that stock.

From the Government's point of view, the transaction fits the classic example of "a deal too good to be true." It argues that for tax purposes there was really no dividend at all. Instead, the court is urged to ignore the form of the transaction and to view the stock distribution simply as an integral step in a transaction in which Falls and Carbon were sold to Carborundum. By that reasoning, it is asked that we consider the value of the transferred basis to be part of the gain realized by Basic on its sale of the two stocks.

Basic stresses the fact that the stock transfer was necessary in order to put Basic, the seller, in the position of being able to meet Carborundum's requirement that it (Carborundum) purchase the shares of both subsidiaries directly from the parent company. Thus, the point Basic would make is that there was a valid business purpose for the move and, at the same time, the negation of any tax-inspired self-dealing.

This argument cannot be accepted. To begin with, it provides a less-than-complete explanation to say that the transaction took the form it did simply because that was the way Carborundum had wanted it. In actuality, if Carborundum's demands had alone controlled the shape of the transaction then the purchase would have involved an acquisition of the assets of the two companies rather than their stock. The fact is, however, that Carborundum's preferred approach was not undertaken simply because there were tax considerations attendant to the transfer in that form which had prompted Basic to demand off-setting increases in price. In turn, these price increases were unacceptable to Carborundum. Against this background then, the inference is readily drawn that Carborundum's second offer, in which it changed the form of the transaction but not the price, was acceptable to Basic for precisely the same reasons that the first was not, namely,

tax considerations. It would therefore be unrealistic to assume that Basic's own interests were any less served by the form of the transaction as finally carried out than the interests of Carborundum. Accordingly, to say that the stock transfer was necessary to meet the terms of Carborundum's second offer is no more than half a story.

Nevertheless, the fact that Basic may have been persuaded to go along with Carborundum's offer because of its favorable tax implications would not diminish the value of its argument insofar as that argument is offered to explain the immediate transfer between Basic and Carborundum. That transaction clearly had a business purpose, namely, to effect the sale and purchase of a business; hence, tax minimization considerations would be irrelevant.

However, it is quite another matter to offer that same argument in explanation and justification for the stock transfer that took place between Basic and Falls. The business interests of Falls were distinct from those of its shareholder, Basic. Hence, it will not do to invoke an explanation that has validity only as to Basic, *i.e.*, that the transfer was necessary because Carborundum had wanted it that way. Indeed, if such an explanation were sufficient then all manner of intermediate transfers could lay claim to "business purpose" simply by showing some factual connection, no matter how remote, to an otherwise legitimate transaction existing at the end of the line.

This then brings us to the second part of Basic's argument—the claim, as Basic puts it, that the "distribution * * * had independent significance." Under this heading, Basic points out that the distribution occurred before Basic's board of directors had approved the sale to Carborundum and also before any agreement existed with Carborundum. Additionally, with respect to post-agreement contingencies, Basic stresses that consummation of the sale was subject to a number of conditions including audit verification of financial statements and the buyer's option to avoid the contract in the event of a material change in the financial condition of the two subsidiaries or for such other significant risk considerations as major lawsuits or material fire damage. These points, says Basic, represented real possibilities, any one of which

might have thwarted finalization of the sale while still leaving Basic in possession of the stock of Carbon and hence, the recipient of a dividend.

These points are all unpersuasive. First, with respect to the argument regarding the timing of the stock distribution, that is, that the distribution had occurred before Basic had approved the sale and before there had existed an agreement with Carborundum, this argument presents a point more illusory than real. The stock transfer did not occur until *after* the receipt of Carborundum's formal offer on November 23, 1964. Much more important than that even is the fact that Carborundum's formal offer was irrevocable by its own terms until November 27, 1964—a circumstance which thus assured Basic and Falls that they could proceed with the stock transfer in the certain knowledge that all elements necessary to finalization of the transaction were in Basic's control alone. This was precisely the way the several steps were carried out: the formal offer was given on November 23, 1964, the transfer of stock was voted upon and carried out on November 24, 1964, and the offer was accepted by Basic on November 25, 1964. Furthermore, the same individuals who had been responsible for setting up the sale between Basic and Carborundum were likewise the individuals responsible for effectuating the transfer of the Carbon stock from Falls to Basic. Given these circumstances, it is an empty point to say that the stock transfer had independent significance because it preceded in time Basic's approval of the sale and the existence of a binding agreement with Carborundum. That was purely a happenstance; the whole transaction was a foregone conclusion that might just as well have been carried out in reverse order without changing the attendant risks or final result to the slightest degree.

With respect to the post-acceptance factors that plaintiff also offers in proof of the stock transfer's independent significance, these too contribute little to the point for which they are offered. *In toto*, they represent nothing more than the sort of risk factors that normally remain with a seller after contract execution but before final delivery.

These facts leave no room for a conclusion that a business interest was served by the claimed dividend. From all that

appears, the case is plain that Falls, through its controlling parent, was caused to transfer the property whose sale the parent had decided upon for its own separate purposes. Nothing therefore remains save the obvious: the transaction reduced the tax that Basic would otherwise have incurred in the sale of its own property, *i.e.*, the shares of Falls.

Nor would it change the result to impute to Falls a purpose separate from that which had been imposed upon it. For even if that had been the case, still no more could then be said save that Falls itself had consented to the sale of its property and to that end had transferred the subject of the sale (the shares of Carbon) to Basic to enable it to carry out the transaction. And so viewed, the transaction fits squarely within the rule laid down in *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945), wherein it was held that the gain from a sale which had been embarked upon by the corporation could not be avoided by an abrupt liquidation which left the shareholders to then carry on with the transaction which the corporation had started. As the Court there explained it, "[a] sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. * * * To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." (324 U.S. at 334 (footnote citations omitted).)[6]

Basic cites a number of decisions which it claims are support for a contrary conclusion. Among these is this court's decision in *Dynamics Corp. of America* v. *United States*, 196 Ct. Cl. 282, 449 F. 2d 402 (1971). That case, like this one, involved a distribution in kind (corporate real estate) from subsidiary to parent followed by the parent's later sale of the distributed property. The issue, as here, was whether the transfer was legitimately treated as a dividend.

[6] The *Court Holding* analysis would not alter either the posture or the correctness of the Government's assessment against Basic since, under that analysis, any gain that could be imputed to Falls through its sale of the shares of Carbon would in any event be realized by Basic, and in the same amount, upon its sale of the shares of Falls. In short, the same gain reaches Basic's treasury absent, however, the off-setting advantage of the tax-free transferred basis which the purported dividend would have allowed.

In sustaining the taxpayer's position in that case, two points were stressed: first, the absence of any evidence suggesting that, at the time of transfer, either corporation, parent or subsidiary, was aware of the possibility that the property would be sold 9 months later; second, it was judged that, as a holding company, the distributee parent was in a better position than its manufacturing company subsidiary to sell or to manage the property in question.

The difference between *Dynamics* and the instant situation needs little elaboration. The transfer there was explainable on valid business grounds, a conclusion reinforced by the lack of any sale commitment at the time of transfer as well as by the time lapse involved between the subsidiary's initial transfer of the property and the parent's sale thereof 9 months later. In short, the initial transfer was sustainable as a dividend because distribution by the subsidiary and sale by the parent were seen as unconnected events.

Similarly distinguishable are our decisions in *Sheppard* v. *United States*, 176 Ct. Cl. 244, 361 F. 2d 972 (1966), and *DeWitt* v. *United States*, 204 Ct. Cl. 274 (1974), which plaintiff also cites. Both of these cases involved a donation-in-kind of appreciated property which was thereafter reacquired through purchase from the donee by a corporation controlled by the taxpayer. The transaction offered tax advantages at both ends: the initial transfer provided the taxpayer with a charitable deduction; the reacquisition provided the purchasing corporation with a stepped-up basis. In neither case would the donation have been made had there not existed a realistic opportunity for its recovery by purchase from the donee.

Because reacquisition of the property represented a dominant concern in the taxpayer's choice of donees, the Government, in each case, sought to avoid the tax consequences connected with the gift. Thus, in *Sheppard* it argued against the initial transfer (the taxpayer's gift to the charity) by claiming that, in terms of end result, the entire transaction actually amounted to a sale by the taxpayer to his controlled corporation; in *DeWitt* it argued on more straightforward grounds contending simply that the taxpayer's gift had only been a conditional one. Common to both arguments was the thought

that the donation to the charity was simply an intermediate step that served no legitimate business function but was only a move designed to generate favorable tax results.

The Government's arguments did not prevail. In each case the decisive point was that the gifts were bona fide transactions, that is to say, the taxpayer was found to have had the requisite donative intent and had accomplished a complete divestiture of the property. The donee, in other words, had received the property with "no strings attached." Therefore, under these circumstances, it mattered little that tax minimization was also part of the taxpayer's objective or that the gift was only a step towards a different final end. Having departed with all incidents of ownership the transaction was complete unto itself and in seeking to reacquire the property the taxpayer's controlled corporation had to deal with the donee as might any other third party. This meant that reacquisition of the property was an expectation and not a certainty. In this situation the gift stood the test of independent transaction for one could readily say that the donation affected the taxpayer's beneficial interests for reasons apart from the possibility of the property's later reacquisition.

Between this case and *Sheppard* and *DeWitt*, there exists this essential difference: here no reason has been given for the stock transfer save that it played a part in the whole, whereas in the gift cases, the transfer, at the time it was made, served a purpose unrelated to the transaction of which it became a part. The difference between the two is the difference between dependent and independent transfers.

The final case that requires mention is *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451 (1950). There assets which had been received as part of a liquidating dividend (a tax-free distribution) were sold by the receiving shareholders pursuant to a plan which they, as individuals, had collectively determined upon while the corporation was still in existence. It was the Government's contention that the sale was actually a sale by the corporation and that it therefore owed a capital gains tax on the transaction. The argument was rejected. It had been found as a fact by the court

below that at no time had the corporation itself planned to make the sale. Thus, in a tightly drawn holding, the Court said: "Whatever the motive and however relevant it may be in determining whether the transaction was real or a sham, sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes." (338 U.S. at 455.)

The point which plaintiff draws from the *Cumberland* case is the contention that taxes are to be assessed according to what actually happened and not according to a fictitious restructuring of events which maximize the revenue based upon a hypothetical situation. Since the bona fides of the corporate liquidation and shareholder sale were honored as independent transactions in that case, so, likewise, it is claimed, should the distribution followed-by-sale arrangement that took place here.

On the surface the argument has appeal but its problem is that it builds upon too loose a reading of the *Cumberland* decision. That case stands essentially for the rule of corporate recognition, that is, that a corporation, though closely held, yet remains a legal creature separate and apart from its shareholders. Once that fact is grasped then the result that it reached was predictable: having never itself determined to sell the corporate assets, and having undergone a genuine liquidation, the corporation could not then be charged with the gain later realized on a sale of assets it never made.

Here, of course, no question has been raised regarding the separate identities between Falls, the corporation, and Basic, its shareholder. But the similarities between this case and *Cumberland* go no further than that. The point of departure is to be found in the fact that the property transfer in *Cumberland* was undertaken as an end unto itself. The same was true of the transfers in *Sheppard* and *DeWitt*. In all these cases the object of the transfer was to accomplish a change in legal status between the taxpayer and his property *for reasons independent of the later disposition of that property at the hands of the recipient.* That is clearly not the situation here. In *Cumberland* there was a purpose to liquidate;

in *Sheppard* and *DeWitt* there was a purpose to make a gift. It happened only that, in these situations, the tax laws made it possible to combine that objective with still another or, roughly said, "to kill two birds with one stone." Yet that sort of situation is precisely what the law does allow for, as Judge Hand put it in *Gilbert* v. *Commissioner*, *supra*:

> * * * When a taxpayer supposes that the transaction, in addition to its effect on his tax, will promote his beneficial interests in the venture, he will of course secure the desired reduction, for it would be absurd to hold that he must deny himself an economic advantage unless he pay the tax based upon the facts that have ceased to exist. [248 F. 2d at 411.]

Under the facts and circumstances presented here, plaintiff has not shown that there was a reason for the transfer of the Carbon stock from Falls to Basic aside from the tax consequences attributable to that move. Accordingly, for purposes of taxation, the transfer was not a dividend within the meaning of Section 316(a)(1). Instead, it should be regarded as a transfer that avoided part of the gain to be expected from the sale of the business to Carborundum, and should, therefore, be now taxed accordingly. Such a treatment is in keeping with the results reached in like situations. *Steel Improvement & Forge Co.* v. *Commissioner*, 314 F. 2d 96, 98 (6th Cir. 1963); *Commissioner* v. *Transport Trading & Terminal Corp.*, *supra*.[7]

The Government's tax assessment having been correct in principle and in amount, it follows that plaintiff is not entitled to any recovery.[8]

---

[7] A recent revenue ruling, Rev. Rul. 75-493, 1975 INT. REV. BULL. No. 46, at 8, found a dividend in the situation where a corporation's cash distribution to its noncorporate shareholder took place immediately prior to the shareholder's sale of the corporation to a third party. That result is distinguishable from the present case in that the property there transferred (*i.e.*, the cash), while it affected the purchase price, was not itself the intended subject of any later sale at the hands of the recipient. Aside from noting this distinction, we intend no judgment here as to the correctness of the cited ruling. For an apparent contrary ruling, however, *see Steel Improvement & Forge Co.* v. *Commissioner*, 314 F. 2d 96 (6th Cir. 1963).

[8] In the conclusion to its brief, the Government asked that "costs" be assessed against the taxpayer. The costs sought were neither identified by category nor by amount and, absent any specificity with respect to what the requested assessment is meant to entail, it cannot be considered.

Dissenting Opinion by Judge Nichols

NICHOLS, *Judge*, dissenting:

Respectfully I dissent because the evidence leads me to conclude that a good and sufficient non-tax purpose motivated the distribution of Carbon's stock from Falls to Basic. I would find that the form of the transaction amply reflected its substance, and hold that the tax treatment should follow from that. I would treat the distribution of Carbon's stock as a dividend paid by Falls to Basic, just as it purported to be.

First, as to the governing law. I will point out why I differ with the trial judge's opinion as I go along, but I agree with the trial judge that a useful place to begin analyzing this problem is with *Gregory* v. *Helvering*, 293 U.S. 465 (1935), the watershed of the "substance-versus-form" doctrine of our tax law. The trial judge accurately summarizes the outcome in *Gregory:* a taxpayer was denied certain tax advantages because the Supreme Court found her claim to such treatment rested solely upon her literal, but not meaningful, compliance with the tax statute that conferred the benefit. Since its genesis in the context of corporate reorganizations, the doctrine of *Gregory* has enlisted such a following that an inquiry into whether the substance of a transaction corresponds to its form is now appropriate in every area of tax law. Accordingly, wherever there occurs a transaction so heavily laden with tax avoidance motives that it appears to be a sham, our courts are justified in disregarding the mere formalisms and recasting the transaction as its economic substance suggests. *See*, B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, ¶14.51 at 14–99 (1971).

Of course, the *Gregory* doctrine is not without its limits; courts are not entitled to discard routinely the form given to taxpayers' affairs as if form were merely a dispensable wrapper surrounding a distinct substance within. "The solution of hard tax cases requires something more than the easy generalization that the substance rather than the form of a transaction is determinative of its tax effects, since in numerous situations the form by which a transaction is effected does influence or control its tax consequences." *Waterman S. S. Corp.* v. *Commissioner*, 430 F. 2d 1185, 1192 (5th Cir. 1970); *United States* v. *General Geophysical Co.*, 296 F. 2d

86, 87 (5th Cir. 1961). The courts are not licensed to distort the law, to write in new provisions, or to render present provisions nullities; the doctrine is reserved to enable the courts to "guard against giving force 'to a purported transfer [that] gives off an unmistakably hollow sound when tapped.'" 430 F. 2d at 1196; 296 F. 2d at 89. Thus, *Gregory* is multidimentional. I agree with the trial judge that Judge Learned Hand was—in *Gilbert* v. *Commissioner*, 248 F. 2d 399 (2d Cir. 1957)—among the most successful in distilling *Gregory's* meaning to an aphorism, but I prefer to rely on somewhat more of Judge Hand's language than the trial judge quoted:

> * * * If * * * the taxpayer enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it; * * * When a taxpayer supposes that the transaction, in addition to its effect on his tax, will promote his beneficial interests in the venture, he will of course secure the desired [tax] reduction, for it would be absurd to hold that he must deny himself an economic advantage unless he pay the tax based upon the facts that have ceased to exist. * * *

*Id.* at 411.

The touchstone, therefore, that distinguishes a transaction worthy of being recognized as it appears from one deserving to be disregarded is the presence of a "good business purpose" rather than the absence of any desire on the taxpayer's part to save taxes. The taxpayer's purpose to escape taxes is legally neutral. *Chisholm* v. *Commissioner*, 79 F. 2d 14 (2d Cir. 1935). "[T]here is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. * * * [N]obody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions." *Commissioner* v. *Newman*, 159 F. 2d 848, 850–51 (2d Cir. 1947) (L. Hand, J., dissenting on other grounds). I would hold that Basic is entitled to favorable tax treatment if its method of selling its subsidiaries furthered its business interests, even if Basic chose one means of accomplishing this over the alternatives because this one exposed it to the least tax.

Second, as to the facts. As I see our task, we now must examine the facts of record to determine whether the tax-

payer acted in pursuit of a legitimate business purpose in selecting the form given the transaction, regardless of any motive to minimize its tax. I am convinced by the record that such a business purpose was present, while the majority, apparently, was not. We quarrel over the legal significance to be given the facts. I should pause here to point out that I do not contend that the trial judge's factual findings are erroneous, as far as they go, even though I find that they do not go far enough. This is a case comfortably within the scope of our duty to review the findings of our trial judges where necessary, even in the absence of suitable exceptions. *Miller* v. *United States*, 168 Ct. Cl. 498, 339 F. 2d 661 (1964). In any event, plaintiff has excepted to the trial judge's Ultimate Finding (No. 37), which serves to bring the underlying factual questions properly before us.

Usually, it is the taxpayer's own business purpose that attracts the court's attention. Where the taxpayer establishes that it acted to further its own business, the question is resolved in the taxpayer's favor, and the transaction taxed as it appears. In an arm's length transaction the business purpose may also be that of the party other than the taxpayer, who insisted on it for his own business reasons. Here, the taxpayer relies for its business purpose on Carborundum's desires to structure the purchase of taxpayer's subsidiaries in a particular way, and the trial judge correctly desired to know whether Carborundum's position was itself supportable by legitimate business considerations. The trial judge's concern is well-taken, for this might have been an instance of collusion if, for example, the taxpayer sought to protect itself by putting the words of its defense in the mouth of another corporate taxpayer, which it controlled. If that kind of self-dealing were found here, I would agree with the majority's result. Similarly, I would agree if self-dealing took another form, as in *Waterman S. S. Corp.* v. *Commissioner*, *supra*, where just before it was sold to another corporation, the taxpayer's subsidiary transferred cash to the taxpayer, as an obvious advance of the purchase price. There was no such evidence here, however, and none of the trial judge's findings suggest collusion. To the contrary, Finding 31 states that "Carborundum and Basic were unrelated parties that dealt

with one another on an arm's length basis." And the trial judge further recognized that Carborundum acted in furtherance of its own interest in proposing the sale of stock by Basic and that Carborundum's proposal was not intended to confer tax advantages upon Basic. (Findings 14, 24.) These findings are probably inspired by the uncontradicted testimony of Carborundum's assistant treasurer, Mr. Lebold, who explained the considerations that motivated Carborundum's management to insist upon purchasing both Falls' and Carbon's stock directly from Basic.

In summary, Carborundum originally proposed to buy assets only leaving the corporate stock untouched. Basic rejected this except at a price Carborundum did not wish to pay, $265,000 above the price the executives had already agreed on in principle. This was because of unfavorable tax consequences that Basic anticipated from a sale of assets that included depreciated facilities, on which any gain over basis would be taxable as ordinary income, and also, no doubt, inventory. No one suggests that Basic should now have to pay the taxes such a sale would have generated. This left stock sales as the remaining options the parties could have. They might be as follows:

(A) Carborundum might buy the Falls stock from Basic, leaving the Carbon stock undisturbed in Falls' treasury. Carborundum objected to this because it could not have allocated part of the purchase price, over the book values, to make a new basis for Carbon's assets. Carbon in fact owned a substantial part of the assets Carborundum wished to acquire.

(B) Carborundum might buy the Carbon stock from Falls and then buy the Falls stock from Basic. Carborundum objected to this for both tax and non-tax reasons. The tax objection was that Falls would have realized a taxable gain which Carborundum, as its new owner, would have had to pay, even if indirectly. The non-tax reason was that Carborundum would have had no contractual recourse except against itself had the Carbon assets been found to be not as represented.

(C) Carborundum might buy the stock of each subsidiary from Basic. To make this possible, the Carbon stock had to be got from Falls' treasury into Basic's. No matter how accomplished, this would have appeared to be a dividend for tax law purposes, and under other

circumstances, the IRS would probably have insisted it was a dividend even if called something else.

It would seem that, from Carborundum's point of view, option C had to be adopted because there existed fatal objections to A and B. It is not apparent what other options there could have been. It remains to inquire whether these considerations were actually in Carborundum's mind at the time or were afterthoughts. It is now time to look at Mr. Lebold's testimony in the record:

> PLAINTIFF'S COUNSEL. What was the reason for your suggesting that Carborundum purchase the stock of Carbon from Basic?
>
> MR. LEBOLD. Well, the reason was that * * * there was a substantial premium we were paying over the book value or the tax basis of the assets [in] the respective companies. If we bought the shares for cash we could liquidate [both subsidiaries] under section 334(b)(2) [of the Internal Revenue Code] and write up the assets to their respective fair market values. [Transcript at 77–78.]
>
> PLAINTIFF'S COUNSEL. Was it then your opinion that the price to be paid could not be satisfactorily allocated to the assets of the two companies if Carborundum simply purchased the stock of Falls from Basic?
>
> MR. LEBOLD. Yes, definitely. You have to purchase at least 80% of the shares of a company in order to meet the requirements of * * * section 334(b)(2).
>
> PLAINTIFF'S COUNSEL. Were you desirous of purchasing the stock of Carbon so that you could attribute the price paid for that stock to the assets of Carbon?
>
> MR. LEBOLD. Yes, we were because the assets of Carbon contained some intangibles that were more valuable than assets held by Falls, so we wanted to purchase each company's shares. [Transcript at 78–79.]

On subsequent cross-examination, Mr. Lebold participated in this exchange:

> GOVERNMENT'S COUNSEL. Why did you not consider * * * buying the Carbon shares from Falls and then buying the Falls shares from Basic?
>
> MR. LEBOLD. Well, that didn't seem to be the clean way to handle the transaction if we even gave it serious thought * * * it seems to me it would be quite awkward and not even feasible[. I]f we had bought the shares [of Carbon] from Falls, then Falls would have a gain. Then

> if we wanted to buy the shares of Falls from Basic, Inc., we would have to pay a bigger price because the profit on the sale of Carbon would be in Falls. [Transcript at 87.]

Mr. Lebold later elaborated on this "awkwardness" in response to the trial judge's request for clarification of Carborundum's position. Mr. Lebold replied:

> * * * it seemed to me that if we had bought the shares [of Carbon from Falls] there probably would have been a gain that Falls would have had on the sale. Then we would have this profit in Falls. Let's see, if we bought the Falls shares from Basic, Inc., we would have to pay for the profit twice, wouldn't we? [Transcript at 106.]

I believe that Mr. Lebold was correct that Carborundum would have paid twice if the transaction were attempted in this manner. If Carborundum had paid Falls the cash price for Carbon's stock, Falls and not Basic would have realized the profit. If Basic could not have reached that profit, it would reasonably expect that Carborundum, in the next step of the transaction, would pay for Falls stock an amount that represents the expected profit on both Falls' and Carbon's stocks. As Mr. Lebold anticipated, Carborundum would thus have paid twice for Carbon, first to Falls and then to Basic. And after Falls became a part of Carborundum's corporate organization, it must still pay a tax on the gain realized upon selling Carbon's stock. In the end, Carborundum would have transferred funds from one of its corporate pockets to another, serving no purpose but incurring a tax nevertheless. Awkward indeed! There might have been additional alternatives, but each would have injected an awkwardness of its own. Carborundum could have, for example, paid a lower price for Carbon stock and a higher price for Falls, but thereby it would sacrifice its ability to allocate its costs among Carbon's valuable assets, which was Carborundum's primary purpose from the outset. Similarly, if Carborundum purchased solely Falls' stock from Basic, it would not have been entitled to invoke section 334(b)(2) upon liquidating Carbon, because Carborundum would not have purchased 80% of the stock of Carbon as that section requires.

I would be satisfied with this much alone to find that the form chosen for the transaction served the interests of both Basic and Carbon, that there was a sufficient business purpose. But then, on recross-examination, Mr. Lebold proceeded to describe still another dimension to the "awkwardness" involved if Carborundum purchased Carbon stock from Falls:

> GOVERNMENT'S COUNSEL. Could you describe for me what you mean by the term "awkward" in your response just before?
>
> MR. LEBOLD. Well, "awkward" from the standpoint that I just covered [the problem of having to duplicate the profit to Basic], and from the fact that we would be dealing with a company that we are going to turn right around and buy[.] I would sooner deal with a third party and buy companies from them where I could have some recourse if something in the agreement was defective from our standpoint later. [Transcript at 106.]
>
> * * * [This] other consideration is the one in the contract itself. We would rather have an existing company that is on the New York Stock Exchange [as] the seller in case we do have some problems turn up later under the agreement. [Transcript at 107.]
>
> PLAINTIFF'S COUNSEL. [I]s it correct * * * that if you had purchased the stock in * * * Carbon from Falls that would have involved a contractual obligation between you and Falls?
>
> MR. LEBOLD. Yes.
>
> PLAINTIFF'S COUNSEL. Then if you had immediately thereafter purchased the stock of Falls from Basic your first contract relating to the purchase of the Carbon stock would have been between you and your own preaching?
>
> MR. LEBOLD. Yes.
>
> PLAINTIFF'S COUNSEL. Which is not a very satisfactory situation if you need any recourse under the contract?
>
> MR. LEBOLD. That's right.
>
> PLAINTIFF'S COUNSEL. So that the awkwardness did not, in fact, only relate to the tax considerations?
>
> MR. LEBOLD. That's right. [Transcript at 108.]

Little more need be said, in my view, to establish a sufficient business purpose—or, perhaps, several business purposes. I might even entertain the suggestion that the structure chosen by the parties may have been the only way to satisfy both

sides of the deal. In any event, the record places this case beyond the scope of *Commissioner* v. *Transport Trading & Terminal Corp.*, 176 F. 2d 570 (2d Cir. 1949), cited by the trial judge, which advises the courts to withhold tax benefits from "transactions entered upon for *no other motive* but to escape taxation." 176 F. 2d at 572 (emphasis supplied).

The trial judge makes much of the fact that the taxpayer and Carborundum actively considered how the tax results would differ depending on how they chose to structure the transaction. It can be said bluntly, I think, without undermining their respective positions, that both Basic and Carborundum sought to consummate the deal at the smallest tax cost. This is no more than a taxpayer's legitimate desire to escape taxes, which is legally neutral so long as the form of the transaction is otherwise supported by the taxpayer's business interests. Since I cannot conclude, upon reviewing the record, that the stock distribution was "a mere device * * * a disguise for concealing its real character" inveighed against in *Gregory* v. *Helvering*, *supra*, I would sustain the taxpayer's refund claim.

## FINDINGS OF FACT

**1.** Plaintiff, Basic Incorporated (hereinafter Basic), is an Ohio corporation having its principal office in Cleveland, Ohio.

**2.** During the time period relevant here, 1963–1964, Basic's principal business involved the production and sale of basic refractory materials for use largely in steel-making furnaces.

**3.** On May 10, 1963, Falls Industries Incorporated (hereinafter Falls), became a wholly owned subsidiary of Basic through merger. In this transaction Basic issued to the shareholders of Falls 63,228 shares of its own 5 percent cumulative convertible preference shares in exchange for the outstanding Falls shares. Basic's adjusted basis for its stock in Falls at this time was $1,134,076.35.

**4.** At the time of its acquisition, Falls was engaged in the manufacture and sale of processing equipment made wholly or in part from impervious graphite and certain specialized carbon and graphite formulations. This business was con-

ducted at two plants, one located in Solon, Ohio; the other in Sanborn, New York.

5. On January 1, 1964, Falls transferred its Sanborn plant and related assets, which together had an adjusted basis of $501,869.75, to a then newly organized New York corporation called Basic Carbon Corporation (hereinafter Carbon). Falls, in return for this transfer of assets, received all the stock of Carbon. As of January 1, 1964, Basic owned all of the outstanding stock of Falls, and, in turn, Falls owned all of the outstanding stock of Carbon. Thus, Basic was the parent company, Falls the first-tier subsidiary, and Carbon the second-tier subsidiary.

6. In August 1964, discussions were initiated between Basic and The Carborundum Company of Niagara Falls, New York (hereinafter Carborundum), concerning possible business transactions between the two companies. Initially, these discussions concerned a possible merger of Basic into Carborundum. At some time prior to the meeting of the executive committee of Basic on October 8, 1964, the discussions between Basic and Carborundum also came to include the possible purchase by Carborundum of the carbon and graphite business conducted by the Falls and Carbon subsidiaries.

7. Later, at the October 8th executive committee meeting, the consensus reached was that management should continue its discussions with Carborundum concerning the merger or purchase possibilities that had been explored between the two companies up to that time. By mid-October 1964, however, Basic had decided against a merger with Carborundum.

8. During October 1964, Basic had also been considering its own expansion of the carbon and graphite business conducted by Falls and Carbon and, to that end, alternative methods of financing such expansion were then also under examination. At a meeting of the board of directors of Basic on October 21, 1964, it was concluded that one or more business partners should be sought to assist Basic in financing this contemplated expansion. With this in mind discussions were had with Carborundum and at least two other companies. At the same time, Basic was also consulting with financial advisors as to other likely methods of financing the

possible expansion. However, Basic eventually realized that it could not afford the simultaneous capital outlays that would be required for the continuous development of its basic refractory business on the one hand, and the costs involved in going forward with an expansion of the carbon and graphite business on the other. For this reason, Basic came to consider the sale of its carbon and graphite business.

**9.** Prior to November 6, 1964, no tentative agreement or other understanding had been reached between Basic and Carborundum as to the purchase and sale of the carbon and graphite business conducted by Falls and Carbon. On November 6, 1964, Mr. Eells, the chairman and president of Basic, and vice-president of finance for Basic, met in Niagara Falls, New York with Mr. Wendel, the chief executive of Carborundum and with other officers of Carborundum to discuss the possible sale to Carborundum of the carbon and graphite business of Falls and Carbon. At this meeting, Messrs. Eells and Wendel tentatively agreed on a price of $3,935,000 for the sale of the business plus the repayment by Carbon of $1,000,000 which it had been advanced by Basic.

**10.** During the course of the November 6, 1964, meeting, no understanding or agreement was reached concerning the details of the purchase transaction or the form in which it should be carried out.

**11.** Subsequent to reaching the tentative agreement on price for the sale of the Falls and Carbon business to Carborundum, Mr. Ludwig and officials of Carborundum began negotiations to work out the details of the transaction including, of course, such matters as the form the transaction was to take. Since Carborundum was primarily interested in obtaining the assets of the two companies involved, it first proposed that the transaction take the form of a purchase of the assets of Falls and Carbon.

**12.** Basic's reaction to this first Carborundum proposal was that if the transaction were to take the form of a sale of assets, then the tentative purchase price earlier reached between Messrs. Eells and Wendel would have to be increased by $265,000 to allow for various tax and management considerations. Additionally, Carborundum would then also have to agree to indemnify Basic for any further assessment

of taxes that might become payable on the transaction in excess of those taxes which Basic could anticipate and compute in advance. These additional considerations which Basic had raised were not acceptable to Carborundum and, hence, no agreement was reached on a sale of assets.

**13.** Since Carborundum was chiefly interested in acquiring the assets of Falls and Carbon, it next proposed that it purchase from Basic all of the Falls and Carbon stock. Carborundum's purpose in making this second proposal was to enable it to buy the stock of both companies for cash and thereafter to liquidate them so as to acquire their assets and then allocate the aggregate purchase price paid for the stock of the two companies to their respective assets in accordance with Section 334(b)(2) of the Internal Revenue Code of 1954.

**14.** This second proposal was made by Carborundum because it was seen by that company to be in its own best interests; the proposal was not made for the purpose of specifically granting Basic any tax advantages that might not otherwise result were the transaction to be cast in a different form. However, Basic, in acting in its own behalf, did consider the tax consequences of the proposed transaction as well as alternative approaches that might be taken. Because it found the offer as made to be satisfactory, it accepted Carborundum's second proposal.

**15.** In a report to the board of directors of Carborundum, dated November 17, 1964, it was explained that, while Carborundum would have preferred to purchase assets only, it remained advantageous for Carborundum to purchase the stock of Falls and all the stock of Carbon directly from Basic and that Basic would, therefore, be requested to transfer the ownership of Carbon stock from Falls to Basic prior to the transaction.

**16.** At a meeting of the Carborundum board of directors on November 19, 1964, approval was given to recommendations for the purchase of all the stock of Falls and all the stock of Carbon from Basic for $3,935,000 in cash and to an agreement to pay the debt of Carbon to Basic in the amount of $1,000,000. Also approved was the purchase of certain land in Hickman, Kentucky, then being acquired by Basic.

**17.** By letter, dated November 23, 1964, Carborundum made a formal offer to Basic to: (a) purchase from Basic all the stock of Falls and all the stock of Carbon for $3,935,000; (b) buy, or cause to be paid, the $1,000,000 debt of Carbon to Basic; (c) reimburse Basic up to $100,000 for advances made to Falls and Carbon between October 31, 1964, and the closing date; and (d) purchase at Basic's cost all its rights to acquire properties in Hickman, Kentucky. The offer provided for a closing date of December 31, 1964, or such other date as might be agreed upon. The offer was irrevocable, by its own terms, until November 27, 1964.

**18.** On November 24, 1969, one day after Carborundum had made its formal offer to Basic, a special meeting of the board of directors of Falls was held. Those attending (and who together made up a quorum of the board) were Mr. Eells, Mr. Ludwig, and a Mr. Lee. At the meeting, which was chaired by Mr. Eells (he was also the chairman and president of Basic), it was reported that the company's sole shareholder, namely, Basic, had been discussing with The Carborundum Company the sale by Basic to Carborundum of the shares of Falls' wholly owned subsidiary, Carbon. It was also reported that Carborundum was insisting that it purchase those shares from Basic rather than from Falls directly.

**19.** At the November 24, 1964, meeting (identified in Finding 18), Mr. Eells recommended that Falls distribute the stock of Carbon to Basic as a dividend so as to enable Basic to deal separately with the stock of Carbon and the stock of Falls. Accordingly, after discussion, the following resolution was passed:

> RESOLVED, that a dividend be declared and paid to the holder of all the outstanding shares of common stock of the Company by the distribution to such holder on November 24, 1964 of all the shares of outstanding stock of Basic Carbon Corporation.

**20.** Thereafter, on November 24, 1964, pursuant to the above resolution, all of the stock of Carbon was transferred by Falls to Basic. At the time of this transfer, no shares of stock of Falls were surrendered by the transferee, Basic, in exchange for receiving the stock of Carbon. The transaction

was entirely unilateral in character; by means of it Basic became the legal owner of record of all outstanding shares of Carbon stock.

**21.** At a meeting of the board of directors of Basic on November 25, 1964, acceptance of the Carborundum offer to buy all the stock of Falls and all the stock of Carbon on the terms and conditions contained in the Carborundum letter of November 23, 1964, was authorized. Acceptance of the offer was endorsed on the Carborundum letter by Mr. Eells, the president of Basic, on November 25, 1964.

**22.** The agreement between Carborundum and Basic embodied in the Carborundum letter of November 23, 1964, contained a number of conditions to which Carborundum's obligation to consummate the transaction was subject. Among these was assurance from Price Waterhouse & Co. as to the correctness of the financial statements of Falls and Carbon as of October 31, 1964. In its examination, Price Waterhouse & Co. prepared consolidated financial statements of Falls and Carbon as of October 31, 1964, making adjustments to the common stock equity and net income of Falls and Carbon as reflected in the separate financial statements attached to the agreement embodied in the Carborundum letter of November 23, 1964. The adjustments reduced the common stock equity of Falls and Carbon, as reflected in such separate financial statements, by $48,364. Although Basic felt that the amounts in the separate financial statements were correct, this difference was nevertheless compromised by agreement between Basic and Carborundum resulting in a reduction of the purchase price by $25,000 from $3,935,000 to $3,910,000.

**23.** On December 29, 1964, the sale and transfer of all the stock of Falls and Carbon by Basic to Carborundum was consummated, the adjusted price of $3,910,000 was paid, the debt of Carbon to Basic in the amount of $1,000,000 was paid and other payments and transfers completed, all in accordance with the agreement.

**24.** Except for its initial proposal to purchase the assets of Falls and Carbon, Carborundum made no proposal offer to Basic to carry out the transaction in any form other than a direct purchase from Basic of the stock of Falls and the stock of Carbon. This form of the transaction was proposed

by Carborundum in order to secure business and tax results which Carborundum desired. Carborundum, rather than Basic, suggested that the stock of Carbon be transferred by Falls to Basic so that Carborundum could purchase that stock, together with the stock of Falls, directly from Basic. Purchase of the stock of Carbon from Falls would not have been satisfactory to Carborundum because that approach would have increased the overall price.

**25.** While the purchase price that was paid in the finalized transaction remained substantially the same as that which had been tentatively agreed upon by the chief executives of Basic and Carborundum, that amount was affected by the form in which the transaction was carried out. Had the transaction involved, say, a sale of assets rather than a sale of stock, then Basic's price would have been increased by $265,000.

**26.** With respect to the transaction as finally executed, Basic and Carborundum never discussed alternative purchase prices depending upon whether or not the transfer of Carbon stock to Basic was carried out. However, plaintiff does admit that methods of transferring the Carbon stock to Basic, other than the distribution of that stock as an intended dividend, would have changed the final purchase price or would otherwise have affected the economics of the transaction.

**27.** On June 30, 1965, Falls and Carbon were completely liquidated into Carborundum by transfers of all their respective properties and assets, subject to liabilities, in exchange for, and upon surrender of, all the stock of the two companies.

**28.** The adjusted basis of all the stock of Carbon in the hands of Falls immediately before the transfer of such stock to Basic on November 24, 1964, was $501,869.76. On November 5, 1964, at a meeting of its board of directors, Falls declared a cash dividend to Basic of $275,000, payable December 31, 1964, in order to reimburse Basic for cash dividends that it had paid, and would pay through December 1964, on the 63,228 shares of convertible preferred stock issued by Basic in the May 10, 1963, merger. This cash dividend was paid to Basic prior to the transfer of the stock of Falls to Carborundum. During the period of Basic's ownership of Falls, Falls made no distributions to Basic other than

this cash dividend and the distribution of all the stock of Carbon on November 24, 1964.

**29.** Although the earnings and profits of Falls for the year 1964, plus its earnings and profits accumulated after February 28, 1913, exceeded the sum of $776,869.76, and were thus sufficient to cover the dividend distributions to Basic, Falls did have to borrow some money in order to carry out its cash dividend of $275,000.

**30.** Basic's adjusted basis for its stock in Falls at the time of its acquisition was $1,134,076.35. Basic's adjusted basis for this stock at the time of its sale to Carborundum was $1,136,726.35, the increase being attributable to selling expenses.

**31.** Throughout the course of the negotiations which culminated in the November 23, 1964, offer of Carborundum to purchase all the stock of Falls and Carbon from Basic and the consummation of the transaction which that offer contemplated, Carborundum and Basic were unrelated parties that dealt with one another on an arm's length basis. At all times material hereto, Basic and Carborundum were publicly held corporations whose shares were traded on the New York Stock Exchange.

**32.** Basic used the accrual method of accounting in keeping its books and records and in reporting income in its calendar year corporation income tax return.

**33.** In its federal income tax return for 1964, which Basic filed with the District Director of Internal Revenue, Cleveland, Ohio, the company reported dividend income from Falls in the amount of $501,869.76 as a result of the receipt of the stock of Carbon. Also, it claimed a dividends-received deduction with respect to such dividend income and it reported a long-term capital gain of $2,310,217.52 from the sale to Carborundum of the shares of stock of Falls and Carbon. Income tax in the amount of $1,207,406.36, shown due in such return, was timely paid by Basic.

**34.** During 1970 representatives of the Commissioner of Internal Revenue (the Commissioner) concluded an examination of Basic's federal income tax return for 1964 and determined that the reported gain from the sale of the stock of Falls and Carbon should be increased by $501,869.76 and that the dividend income reported by Basic should be re-

duced by an equivalent amount. As a result of this determination and other adjustments to Basic's return for 1964 which are not in controversy, additional income tax of $68,818.12 for 1964 and interest thereon was assessed against Basic, which additional tax was paid by Basic, $18,703.21 on January 3, 1967, and $50,114.91 on September 3, 1970, with interest thereon as provided by law.

**35.** The period of limitation for assessment of Basic's income tax for 1964 was extended to December 31, 1970, by timely agreements duly executed. On November 3, 1970, Basic filed a claim for refund of 1964 income tax in the amount of $87,827.22 on the ground that it had correctly reported in its 1964 return a dividend of $501,869.76 from Falls as a result of the receipt of all stock of Carbon and that the reduction of its dividend income by that amount and the increase by an equivalent amount in the gain from the sale of the stock of Falls and Carbon were erroneous.

**36.** By letter, dated August 11, 1971, Basic was notified by the Commissioner that its refund claim was disallowed in full. Basic has received no credit or refund of any income tax or interest thereon paid for the year 1964.

ULTIMATE FINDING

**37.** The transfer of the ownership of the shares of Carbon from Falls to Basic was a transfer that was dictated by the sole shareholder, the parent, Basic, in furtherance of a sale of the business which the parent had decided upon for its own purposes.

Alternatively, if the transfer is taken as a self-initiated move on the part of the distributing corporation rather than as a shareholder-dictated distribution, the tax consequences would remain the same. For a corporate transfer that is undertaken in furtherance of an agreed-to sale of the distributed property at the hands of the distributee is, in reality, a sale by the corporation itself. Under this alternative view, the gain realized by Falls on the sale of its own property (namely, the shares of Carbon) would reach Basic's treasury upon the latter's sale of Falls. There would, however, be no dividend.

Syllabus

CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

---

548 F. 2d 953

## VARO, INC. v. THE UNITED STATES

[No. 369–74. Decided January 26, 1977. Defendant's motion for rehearing denied March 4, 1977]

ON PLAINTIFF'S MOTIONS AND DEFENDANT'S CROSS-MOTION FOR SUMMARY JUDGMENT

**Contracts; interpretation; defendant's entitlement to price reduction for elimination of test requirements.**—Plaintiff entered into a fixed-price contract with the Army for fabrication and supply of 135 searchlights and a larger number of xenon lamps, some to be incorporated in the searchlights, some to be furnished as spares. Plaintiff was originally required to furnish "first articles" for testing samples of both the searchlights and the lamps. As to the lamps, Varo was also required to furnish, for the same purpose, two out of the first ten of the regular production run. Varo procured all its lamps by subcontract from Hanovia, Inc. which also had a prime contract with the Army to furnish 200 of the same type of lamp. The first xenon lamps fabricated by Hanovia failed to meet the prescribed electrical characteristics requirements, the lamp specifications were changed and the Army changed the number of lamps to be tested, Varo requested that the lamp specifications in its searchlight contract be similarly revised, and the contracting officer consonant with the Hanovia modification issued a unilateral change order. A dispute arose as to whether the Army was entitled to a downward adjustment in price under the searchlight contract because as a result of the change only four of the 270 lamps involved in that contract had to be tested by Hanovia which reduced Hanovia's costs in testing lamps. However, evidence before the Board showed that Varo did not financially benefit or suffer any detriment from the reduction in Hanovia's costs of performing the subcontract. Hanovia produced all prime and subcontracted lamps in a single production run, scheduling the prime contract lamps first. The Army agreed to accept from Hanovia three out of the first ten lamps in the regular production run, as and or both the "first article" and the initial production samples. The Army arranged for the testing at a cost to it of approximately $6,000 per lamp, and did not pass this cost on to Hanovia. On the basis of the Hanovia lamp testing,

Syllabus

lamps which Varo furnished were accepted without further testing. Although defendant did not at first demand a price reduction for omission of testing, later it asserted entitlement thereto under the Changes Article. The Armed Services Board of Contract Appeals found that the Government was entitled to a reduction in contract price on the ground that elimination of the testing requirements for the lamps resulted in a cost saving to Varo. Plaintiff seeks review under Wunderlich Act standards of the Board's decisions. It is *held* that as to the two initial production lamps, the tests were actually performed, since the first ten of the entire production run, not of the portion scheduled for Varo, were the only ten from which the samples could have been selected. That Varo benefited from having tests of these run without cost is not due to a change order, but to a fortuitous circumstance, of which it is entitled to garner the benefit, even though the original contract was clear that Varo would bear the expense of testing the initial production lamps. As to the three "first article" lamps, it is *held* that the original contract, taken at its best for defendant, was ambiguous as to whether it required Varo or defendant to pay for testing of the lamps furnished as "first articles." Since defendant was the author of the contract, under the doctrine of *contra proferentem*, defendant cannot prevail. Plaintiff's motions for summary judgment are allowed, defendant's cross-motion is denied, and judgment is entered for plaintiff for $37,118.16.

**Contracts; interpretation; ambiguity.**

[1] The rule is that if the language of contract specifications is ambiguous and the contractor's interpretation is reasonable, the ambiguity will be construed against the Government as the author of the document. Where the contract recites that the supplier is to furnish three lamps to prove, prior to starting production, that its production methods will do the job, but the contract fails to say who is to do the inspection, this implies that the contractor was merely to furnish the lamps (or to have them furnished) to the Government for "first-article" testing. At its best for defendant the language is ambiguous.

United States ⊂⇒ 70(3, 14)

**Contracts; changes; equitable adjustment; measure of adjustment.**

[2] The purpose of an equitable adjustment is to keep a contractor whole when the Government modifies a contract. Thus, since alteration of a contractor's position is the proper standard to use in determining whether an equitable adjustment is appropriate and since plaintiff did not derive any financial benefit, or suffer any detriment, from the change made in the lamp specifications relative to testing for electrical characteristics whereby testing requirements for 266 of 270 lamps were eliminated, defendant was not entitled to an equitable adjustment downward in the contract price, even though the subcontractor who furnished the lamps to plaintiff benefited because the benefit was not passed on to plaintiff.

United States ⊂⇒ 70(35)

*Marshall J. Doke, Jr.*, attorney of record for plaintiff. *Daniel J. Riley* and *Rain, Harrell, Emery, Young & Doke*, of counsel.

*Richard J. Webber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS, and NICHOLS, *Judges*.

PER CURIAM: This case comes before the court on defendant's request, filed May 21, 1976, for review of the recommended decision of Senior Trial Judge Mastin G. White, filed on April 15, 1976, pursuant to Rule 166(c), wherein he recommended judgment for the plaintiff on both claims. The plaintiff petitioned for review under the standards of the Wunderlich Act, 41 U.S.C. §§ 321, 322, of two decisions of the Armed Services Board of Contract Appeals (ASBCA), Nos. 16087 and 16146, 73–2 BCA ¶10,206, on motion for reconsideration, 74–1 BCA ¶10,458, construing and applying a contract, No. DAAA BO 7–68–C–0291, for fabrication and supply of 135 searchlights, and a larger number of xenon lamps, some to be incorporated in the searchlights, some to be furnished as spares.

Upon consideration of the recommended decision, together with the defendant's objections thereto and the briefs and oral arguments of counsel, the court agrees with the said decision and adopts and affirms the same as the basis for its judgment in this case. We find no comment by us necessary for addition to the trial judge's observations on ASBCA No. 16087. With respect to No. 16146, the parties invited our closest attention to whether the trial judge misconstrued the contract, and we deem it will be helpful to add a few words to his on that subject, although we fully agree with him.

The procurement being novel, the plaintiff was originally required to furnish the usual "first articles" for testing, samples both of the searchlights and of the lamps, as they were to be, before starting production. As to the lamps, it was also required to furnish, for the same purpose, two out of the first ten of the regular production run, to be selected at random. It procured all its lamps by subcontract from Hanovia, Inc. Hanovia also had a prime contract by which

it furnished 200 of the same type of xenon lamps direct to the Army. It planned to and did produce all the lamps, under both the prime contract and the subcontract, in a single unbroken production run, scheduling the prime contract lamps first. By reason of contract engagements between the Army and Hanovia, with which Varo had nothing to do, the Army agreed to accept three out of the first ten lamps in the regular production run, as and for both the "first articles" and the initial production samples. The Army sent them to General Testing Laboratories, which performed the required tests at a cost to the Government of approximately $6,000 per lamp. There was no effort to pass this cost through to Hanovia.

Varo then suggested, and the Government agreed, that the testing of lamps under its prime contract had become a useless expense. It was eliminated and the lamps were accepted on the basis of the tests above mentioned. There was at the time no caveat that a price reduction would be demanded. However, at a later date defendant asserted that Varo had been let out of performing five tests, three "first article" lamps and two initial production run lamps, and the defendant was therefore entitled to a price reduction under the Changes Article. The Board agreed, measuring the amount of the reduction by the cost of performing five sets of tests at General Testing Laboratories, $30,000 in all. It appears that Varo, if required to perform any of the five, would or might have had to pay General Testing Laboratories itself, unless it could have passed the obligation on to Hanovia pursuant to the latter's subcontract commitment to furnish "qualified" lamps at a final price. More certain grounds of decision appear available.

With regard to the two initial production lamps, the trial judge concludes, and we agree, that the tests were actually performed, since the first ten of the entire production run, not of the portion scheduled for Varo, were the only ten from which the samples could have been selected. That Varo benefited from having tests of these run without cost to it is not due to a change order, but to a fortuitous circumstance, of which it is entitled to garner the benefit. This is true even though, as the trial judge recognizes, the original contract

was clear that Varo would bear the expense of testing the initial production lamps.

As to the three "first article" lamps the issue is much closer, and able counsel on both sides found material in the original contract, going for them. Plaintiff argued that by that contract, it was not obliged to test the "first article" lamps, but only to deliver them for Government testing, so that before any change order the General Testing Laboratories bill would still have been rendered to the Government. Therefore, it was not let out of anything. Defendant would have us find it perfectly clear that the original contract required plaintiff to pay for "first article" testing of the involved lamps.

Defendant finds a linchpin for its argument in Par. 4.1 of the Military Specification, which it says the trial judge "inexplicably failed even to mention." It reads as follows:

> 4.1 Responsibility for inspection.—Unless otherwise specified in the contract or purchase order, the supplier is responsible for the performance of all inspection requirements as specified herein. Except as otherwise specified, the supplier may utilize his own facilities or any commercial laboratory acceptable to the Government. The Government reserves the right to perform any of the inspections set forth in the specification when such inspections are deemed necessary to assure [that?] supplies and services conform to prescribed requirements.

Defendant deduces from this that the contractor must "inspect" which includes testing, at his expense, unless some clear and specific provision assumes this obligation for the Government. It fails to find any such provision in the contract documents. It says the trial judge mistakenly applied provisions written, not for the lamps, but for the searchlights. It is clear the Government originally intended to test the searchlights itself.

Par. 4.3 tells what tests are required under the "inspection" rubric, for the lamps, but fails to say who is to do it. Par. 3.2.1 is quoted by the trial judge. Under the heading: *First Article Model*, the supplier is to "furnish" three lamps "to prove, prior to starting production, that his production methods * * *" will do the job. Defendant says "furnish" means "produce or make available," and the provision sought only to prescribe the number of lamps to be manufactured for

testing. "Furnish" is a protean word. We note, however, the first definition of "furnish" in Webster's Unabridged:

> 1a. To provide or supply with what is needed.

The word thus seems to denote a recipient, having a need. As a verb, it has an object, which may be the thing furnished, or the needy recipient. Whichever it is, the other comes into the sentence by way of a preposition. You "furnish the hungry with food," or you "furnish food to the hungry." The right question therefore is, what recipient is implied here? It seems to be the Government, for how else would the mere furnishing prove anything? The language bears the weight the trial judge places on it; at its best for defendant it is ambiguous.

With respect to the "contract notes" the trial judge next refers to, defendant says the ones he cites refer solely to the searchlights "furnished" as "first articles." The plaintiff answers that when the writer of the "notes" wishes to refer only to searchlights, he says so, as in Note 4a. We think that the "notes" defy explanation according to any consistent and coherent theory; however ICLE 18(i) indicates that the "first article offered" must be manufactured at the facilities where the item is to be produced, or "if the first article is a component," the first article must be manufactured at the facilities where "the component is to be produced." Since the lamps were components, this meant that "first article" lamps had to be produced by Hanovia. The provision appears inconsistent with the idea that these provisions respecting "first articles" in part 2(a) and *ff.* of the notes, refer only to searchlights. The references in these notes to "item 0001" are references to the searchlights, which are designated as "item 0001" in the contract. Since the lamps are components of "item 0001," though also supplied separately, the author's intentions are unclear.

Plaintiff says that Par. 4.1 was boiler plate. That the other specifications and notes were not written with an eye constantly upon it is clear since defendant, contrary to its present theory, spelled out that Varo had to perform the tests on the lamps selected as initial production samples. By defendant's theory, this should have been understood from Par. 4.1. The contracting officer testified at the Board hear-

ing that he would read Note 2(a) as requiring the Government to test the lamps for "first article" approval. The Board elected to disregard this on the basis of its finding that he was confused, but cleared it up in another testimony. If he was at least temporarily confused, he was a charter member of a club which our trial judge and this panel have subsequently joined. If the Government is unable to write specifications its own contracting officers will readily understand, it must expect difficulties with independent tribunals and courts. While we do not address the waiver issue, the fact that defendant's officers did not assert any claim to a price reduction when they first let plaintiff out of performing the tests, is for consideration in determining whether the "confusion" existed then, as it did later.

If we suppose that defendant was protecting itself, it is difficult to see any reason why it would have insisted on performing its own "first article" testing on the searchlights, as it clearly did, but trusted Varo as to the lamps, both being primary items, not mere components.

We conclude that the original contract, taken at its best for defendant, was ambiguous as to whether it required plaintiff or defendant to pay for testing of xenon lamps furnished as "first articles." This being so, by the doctrine of *contra proferentem*, defendant loses on that issue. It is therefore not possible to sustain the Board decision in No. 16146, that plaintiff failed to do work the contract required it to do.

According to the foregoing, as well as to the trial judge's decision which follows, the plaintiff's motions for summary judgment are allowed, the defendant's cross motion for summary judgment is denied, and judgment is entered for the plaintiff in the sum of $37,118.16.

WHITE, *Senior Trial Judge:* In two companion motions for summary judgment, the plaintiff requests the court to review, under the standards prescribed in the Wunderlich Act (41 U.S.C. §§ 321–322 (1970)), determinations made by the Armed Services Board of Contract Appeals on two claims for equitable adjustments asserted by the Government against Varo, Inc. ("Varo"), the present plaintiff, on the ground that certain requirements originally imposed on Varo by the provisions of a contract between the parties had been re-

laxed by the Government, or at least had not been met by Varo. The proceedings before the Board relative to the two claims were designated as ASBCA No. 16087 and ASBCA No. 16146; and the Board's determinations on the claims were announced in the form of a single opinion, dated August 15, 1973.

Under the contract in question, which was numbered DAAB 07-68-C-0291 and was entered into on May 31, 1968, Varo was to produce and deliver to the Army a total of 135 searchlights, together with a maintenance and repair kit for each searchlight. The contract was to be performed over a 2-year period, and Varo was to receive a fixed price of $3,120,000 for the 135 searchlights and accompanying kits.

Each searchlight was to be equipped with a xenon lamp as the major component, and the maintenance and repair kit for each searchlight was to contain a xenon lamp as a spare part. Thus, the contract required Varo to supply a total of 270 xenon lamps to the Army—135 lamps as major components of the searchlights and 135 additional lamps as spare parts.

On June 29, 1968, which was approximately a month after the searchlight contract was awarded to Varo, the Army awarded to a lamp manufacturer known as Englehard Hanovia, Inc. ("Hanovia"), a contract under which Hanovia was to supply 200 xenon lamps directly to the Army. The lamp specification in the lamp contract between the Army and Hanovia and the lamp specification which formed part of the searchlight contract between the Army and Varo were identical.

Thereafter, on September 19, 1968, Varo entered into a subcontract with Hanovia under which Hanovia was to produce and supply to Varo 170 of the xenon lamps which Varo needed for the performance of its searchlight contract with the Army. The subcontract required Hanovia to supply lamps that "qualified" under the lamp specification in the searchlight contract between Varo and the Army (which, as previously stated, was the same as the lamp specification in the Army's lamp contract with Hanovia). The subcontract contained a "special note" which placed upon Hanovia the responsibility of performing all the tests that might be required to qualify the lamps for acceptance under the lamp specification.

When the Army's contracts with Varo and Hanovia—and Varo's subcontract with Hanovia—were made, neither Hanovia nor any other lamp manufacturer had produced a lamp that qualified under the lamp specification previously mentioned. Accordingly, it was Hanovia's responsibility, under its prime contract with the Army and under the subcontract from Varo, to produce such a lamp.

The controversies that are involved in the present litigation will be discussed under headings indicating the numbers assigned by the ASBCA to the respective administrative proceedings.

*ASBCA No. 16087*

The lamp specification, as originally set out in the Varo searchlight contract and in the Hanovia lamp contract, described certain electrical characteristics which each lamp was required to possess, and prescribed a test that was to be performed on each lamp in order to determine whether it possessed the required electrical characteristics. The prescribed electrical characteristics test was phrased as follows in paragraph 4.6.2 of the lamp specification:

> 4.6.2 *Electrical Characteristics.*—The lamp shall be operated for 20 minutes at 20 KW and the lamp voltage shall be measured. At the conclusion of the 20 minute operation at 465 amperes the lamp shall be subjected to 12 cycles consisting of the following: The lamp shall be started at 800 amperes current, and maintained for 5 seconds. The lamp current shall be permitted to drop to not less than 465 amperes within 5 minutes. The lamp shall be turned off for not less than 2 minutes prior to conducting the next cycle. During the 5 second period the lamp voltage and current shall be measured. Operation other than as specified in 3.9.3 or damage to the lamp shall constitute failure of this test.

In the fall of 1968, two xenon lamps that had been fabricated by Hanovia at the outset of its production program were tested in order to determine whether they fully met the requirements of the lamp specification. These lamps failed to meet the prescribed requirements. With respect to the electrical characteristics test, quoted in the preceding paragraph of this opinion, it was discovered during the testing process

that the application to the lamps of 800-ampere pulses for 5-second intervals, as required by paragraph 4.6.2 of the lamp specification, caused melting on anode surfaces.

Following negotiations between Hanovia and the Army, the Army changed the electrical characteristics provisions of the lamp specification in the Hanovia lamp contract so as to provide: (1) that in the performance of the electrical characteristics test, the lamp should be subjected to a starting current of 825 amperes (plus or minus 25 amperes) for a period of 1 second (plus or minus 100 milliseconds) in each of the 12 5-minute cycles of operations, with the lamp voltage and current being measured during the 1-second period; and (2) that the electrical characteristics test should be performed on one lamp out of each group of 100 lamps produced, or on one lamp during each 60 days of production, whichever occurred first.

After the electrical characteristics provisions of the lamp specification in the Hanovia lamp contract were changed by the Army, as outlined in the preceding paragraph of this opinion, Varo requested that the lamp specification in its searchlight contract be similarly revised, without any reduction in the contract price. The contracting officer's designated representative for the Varo searchlight contract and a technical representative of the contracting officer both recommended favorable action on Varo's proposal. However, when the contracting officer issued a unilateral change order in November 1969, making changes in the lamp specification of the Varo searchlight contract identical with those previously made in the lamp specification of the Hanovia lamp contract, the change order provided that an equitable adjustment of the contract price "shall be made."

On March 24, 1970, Varo increased its subcontract with Hanovia by ordering 101 additional xenon lamps in order to complete the performance of Varo's searchlight contract with the Army (only 100 additional lamps were actually needed for this purpose). These lamps were to comply with the revised lamp specification. The unit price for the 101 lamps was identical with the unit price for the 170 xenon lamps originally ordered by Varo from Hanovia in September 1968.

Hanovia produced 271 xenon lamps for Varo, and successfully tested four of these lamps for electrical characteristics, in accordance with the lamp specification, as changed.

A dispute arose between the contracting officer and Varo as to whether the Army was entitled to a downward adjustment in the contract price under the searchlight contract because the result of the change in the lamp specification was to relieve Varo—and, therefore, Hanovia—of the necessity of testing, for electrical characteristics, 266 of the 270 xenon lamps which Varo was required to furnish, and did furnish, the Army in the performance of the searchlight contract. The outcome of the dispute was a decision by the contracting officer to the effect that the contract price should be reduced by the amount (as subsequently revised) of $13,861.80.

Varo took an appeal to the Armed Services Board of Contract Appeals from the contracting officer's decision mentioned in the preceding paragraph. After a hearing, the Board rendered its decision of August 15, 1973.

The evidence before the Board showed that the changes in the lamp specification previously mentioned did not have any effect on Varo's costs in performing its searchlight contract with the Army. Before the changes were made, Varo had entered into a subcontract with Hanovia under which the latter was to manufacture and supply to Varo, at a fixed price, xenon lamps that "qualified" under the lamp specification. The subcontract price was firm, and it covered the testing by Hanovia of lamps to ensure that they possessed the essential electrical characteristics. Thus, Varo's costs involved in procuring the lamps from Hanovia were not reduced by reason of the Army's action in reducing the number of lamps that had to be tested for electrical characteristics.

On the other hand, since the original requirements that every lamp be tested for electrical characteristics was relaxed by the Army to the extent that only four of the 270 lamps involved in the searchlight contract had to be tested by Hanovia, this change did reduce to some extent Hanovia's costs in testing lamps for electrical characteristics under the subcontract from Varo. On this point, the Board made a factual finding "that elimination of 266 tests resulted in a cost saving to Hanovia of $7,118.16 (266 × the $26.76 per lamp actual cost as performed by Hanovia)."

In discussing the problem of whether, under the circumstances, the Government was entitled to an equitable adjustment downward in the contract price, the Armed Services Board of Contract Appeals said:

> * * * Where work or material is deleted regardless of who is to perform the work or supply the material, there is a presumption that the prime contractor will benefit by the saving. If the prime contractor has made subcontracts which unreasonably frustrate the Government's right to obtain such savings via the contractual chain, this is a problem which the prime contractor must solve on his own. * * *

The Board concluded its consideration of ASBCA No. 16087 by deciding that the Government was entitled to a reduction of $7,118.16 in the contract price, this being the amount by which (according to the Board's finding) Hanovia's costs of performing its subcontract with Varo were reduced as a result of the Army's action in reducing the number of lamps to be tested for electrical characteristics from 270 to four.

However, the "presumption that the prime contractor will benefit by the saving" involved in a contractual change was overcome in this instance by evidence before the Board showing that Varo, the prime contractor, did not benefit from the reduction in Hanovia's costs of performing the subcontract.

This court has used the following language in defining the standard that should be utilized to determine whether a contractual change justifies an equitable adjustment in a contract price:

> Equitable adjustments * * * are simply corrective measures utilized to keep a contractor whole when the Government modifies a contract. Since the purpose underlying such adjustments is to safeguard the contractor against increased costs engendered by the modification, it appears patent that the measure of damages cannot be the value received by the Government, but must be more closely related to and contingent upon the altered position in which the contractor finds himself by reason of the modification. * * * [*Bruce Construction Corp.* v. *United States*, 163 Ct. Cl. 97, 100, 324 F. 2d 516, 518 (1963).]

In the present case, as previously stated, Varo's position was not altered to any extent by reason of the Army's action in changing the number of lamps to be tested for electrical characteristics. The price that Varo had to pay Hanovia for 270 lamps which "qualified" under the lamp specification was the same, irrespective of whether Hanovia tested 270 lamps, or only four lamps, to determine that the lamps possessed the essential electrical characteristics.

To summarize the situation, Varo did not derive any financial benefit—or suffer any detriment—from the change that was made in the lamp specification relative to testing for electrical characteristics. Since alteration in a contractor's position is the proper standard to use in determining whether an equitable adjustment is appropriate, it necessarily follows that the Armed Services Board of Contract Appeals erred in awarding the Government an equitable adjustment downward of $7,118.16 in the contract price, on the claim involved in ASBCA No. 16087.

If the Board's award of $7,118.16 to the Government in ASBCA No. 16087 were to be consummated, this would place Varo in a worse financial situation than it would have been in if the original provision of the lamp specification relative to testing for electrical characteristics had remained in effect, without change. This would be contrary to the court's pronouncement that the purpose of an equitable adjustment is "to keep a contractor whole when the Government modifies a contract."

It might be mentioned, in connection with this particular point, that there is no showing of any disadvantage or detriment suffered by the Government because only four lamps, rather than 270 lamps, were tested for electrical characteristics by Hanovia. Despite the reduction in the number of lamps tested for electrical characteristics it appears that the Government still received the number of lamps, and lamps of the quality, which it had contracted for with Varo.

Hanovia did derive some financial benefit, under its subcontract with Varo, from the relaxation of the requirement concerning the number of lamps that had to be tested for electrical characteristics. However, this circumstance does not entitle the Government to an equitable adjustment downward in the price of the prime contract with Varo, since

Hanovia's benefit did not inure to Varo, the prime contractor. Consequently, it is not necessary to consider a contention by the plaintiff in the present litigation that the Board's factual finding that Hanovia's financial benefit from the testing change amounted to $7,118.16 is not supported by substantial evidence in the record.

*ASBCA No. 16146*

In this portion of the case, the court is asked to review a decision by the Armed Services Board of Contract Appeals that the Government was entitled to an equitable adjustment downward of $30,000 in the price of Varo's searchlight contract on the ground that Varo did not, in accordance with the contract, perform first-article tests on three xenon lamps, and did not perform initial-production tests on two lamps. The Board made a factual finding, in connection with this point, that the cost of performing the first-article tests and the initial-production tests would have been $6,000 per lamp.

As indicated in the preceding part of this opinion, Varo was required to furnish to the Army a total of 270 xenon lamps in performing the searchlight contract; and Varo entered into a subcontract with Hanovia under which the latter was to manufacture, test, and supply to Varo "qualified" lamps that Varo needed in performing the searchlight contract. Also, the Army entered into a prime contract with Hanovia, under which Hanovia agreed to furnish, and did furnish, 200 xenon lamps directly to the Army.

The Army's contracts with Varo and with Hanovia each initially required first-article testing of three preproduction xenon lamps and initial-production testing of two lamps selected by the Government at random out of the first 10 lamps produced after the start of the regular production run. As stated previously in this opinion, no xenon lamp qualifying under the lamp specification involved here had been manufactured as of the time when the Army entered into the contracts with Varo and with Hanovia; and the prescribed first-article and initial-production testing was designed to ensure that the lamps produced under the two contracts would fully comply with the requirements of the pertinent lamp specification.

The Army's contract with Hanovia initially provided that the first-article tests on xenon lamps under that contract would be performed by the Government and that the initial-production tests would be performed by Hanovia. On January 13, 1969, however, a supplemental agreement was made between the Army and Hanovia, which provided that Hanovia would perform both the first-article and the initial-production testing of xenon lamps under the Army's prime contract with Hanovia, but that the first-article tests would be performed concurrently with, and on the same two lamps to be used for, the initial-production tests.

Hanovia successfully completed the first-article and the initial-production testing of two xenon lamps in April 1969; and Hanovia's report on these tests was approved by the Army on June 5, 1969.

Hanovia, in producing xenon lamps, did not distinguish between the lamps which it needed to fulfill its prime contract with the Army and the lamps which it needed to fulfill its subcontract with Varo. It made a continuous production run, after the approval of the first-article and initial-production tests, and then allocated the lamps, as needed, to its prime contract with the Army and its subcontract with Varo.

On June 30, 1969, Varo submitted to the Army a first-article and initial-production test report, which stated in pertinent part as follows:

> * * * Hanovia successfully completed their qualification testing under contract DAAB07-68-C-0430 [Hanovia's prime contract with the Army]. This lamp will be used in production searchlights * * *.

Varo attached to its test report a copy of Hanovia's test report on xenon lamps, which, as previously stated, had been submitted to, and approved by, the Army under Hanovia's prime contract with the Army.

Varo's first-article and initial-production test report, based on Hanovia's testing of xenon lamps, was approved by the contracting officer on July 17, 1969, in a communication which simply stated, without any qualification or reservation, that the test report submitted under Varo's contract was approved.

Per Curiam

Some time after Varo's first-article and initial-production test report was approved by the contracting officer on July 17, 1969, a successor contracting officer demanded payment by Varo of $46,603.17 (later reduced to $32,993.69), on the ground that Varo had failed to perform first-article and initial-production tests on a total of five xenon lamps. Varo appealed to the Armed Services Board of Contract Appeals from the successor contracting officer's decision.

The Board found that it would have cost Varo $6,000 per lamp to perform first-article testing of three xenon lamps and initial-production testing of two xenon lamps. The Board, although agreeing with Varo that it would not have made any "economic sense" for Varo to run a second series of first-article and initial-production tests after Hanovia, the manufacturer of the lamps, had successfully performed a series of such tests, nevertheless held that the "Omission of one series of tests resulted in a saving, and it is precisely that saving which the Government is claiming, and which the Board rules should be paid to the Government." Accordingly, the Board decided that the Government was entitled to an equitable adjustment downward of $30,000 ($6,000 per lamp × 5 lamps) in the price of Varo's searchlight contract.

One of the issues involved in this aspect of the case is whether, as held by the Board, Varo was obligated by its contract with the Army to perform (or to have performed) first-article and initial-production tests on a total of five lamps.

In connection with the problem just mentioned, it is clear—and Varo does not contend otherwise—that Varo had the responsibility of performing (or having performed) initial-production tests on two lamps, "selected at random by the Government from the first 10 lamps being produced from production tooling * * * to determine conformance with the requirements of this [lamp] specification."

With respect to the matter of first-article testing, paragraph 3.2.1 of the lamp specification provided in part as follows:

> 3.2.1. *First Article Model.*—The supplier shall furnish three lamps within the time frame specified in the contract or purchase order to prove, prior to starting production, that his production methods will produce lamps that comply with the requirements of this speci-

> fication. Examination and tests shall be those specified herein. * * *

Although the provision of the lamp specification quoted in the preceding paragraph did not expressly state who was to perform the first-article tests[1] on the three preproduction lamps, the statement that the supplier should "furnish" three lamps for testing clearly implied that Varo was merely to furnish the lamps (or to have them furnished) to the Government for first-article testing by the Government.

This view derives support from certain provisions contained in the "contract notes" which formed part of Article 1 of the basic contract between Varo and the Army. For example, paragraph "a" of note 2 stated in part that "The approved first article samples will be *returned* to the contractor for reconditioning after first article testing is completed" (emphasis supplied).

Thus, it appears that the contract between Varo and the Army, at least as originally entered into, placed the responsibility on the Government to perform first-article tests on three xenon lamps, and placed the responsibility on Varo to perform (or to have performed) initial-production tests on two xenon lamps.

In connection with this point, consideration should be given to a portion of paragraph "c" of note 2 and to note 3, as initially phrased and as subsequently revised.

Paragraph "c" of note 2 initially provided in part as follows:

> The Government will subject the first article to the following tests:
> Tables I and II of Military Specification MIL–S–55572(EL) for Searchlight * * *, and to any other nondestructive tests considered necessary by the Government to assure that the first article meets the requirements of the contract and its subsidiary documents.

Note 3 initially provided that "One hundred eighty (180) days after date of award of contract, the two first articles shall be delivered for Government testing to" the U.S. Army Electronics Command at Fort Belvoir, Virginia; and that

[1] Paragraph 4.4 stated that the examination, or inspection, of the first-article models was to be performed by the contractor, under the supervision of a representative of the contracting officer, but was silent as to who was to perform the tests.

"The Government will require thirty (30) calendar days to conduct testing and notify the contractor of the result of the tests."

Later, a change order (1) amended paragraph "c" of note 2 by eliminating the phrase "The Government will subject the first article to the following tests" and substituting for it the phrase "The first articles shall be subjected to the following tests"; and (2) revised note 3 in its entirety so as to read as follows:

> NOTE 3—The first article testing shall be conducted by the contractor concurrently with the initial production testing on the same two (2) production units as subjected to the initial production testing.

If the quoted portion of paragraph "c" of note 2 and note 3, as changed in the manner indicated in the preceding paragraph of this opinion, should be construed as applying to xenon lamps apart from searchlights, this would mean, of course, that Varo thereby become responsible for performing (or having performed) first-article tests on xenon lamps as well as initial-production tests, but it would also mean that all such tests were to be performed on the same two production lamps.

In any event, therefore, Varo's obligation for the sort of testing discussed in this part of the opinion was limited to two lamps, and did not extend to five lamps, as held by the Board.

It appears, from the previous summary of the evidence, that there was actual compliance with the testing requirement, irrespective of whether it was Varo's obligation to perform (or to have performed) only initial-production tests on two lamps, or to perform both first-article and initial-production tests on two lamps.

Hanovia produced, in one continuous production run, all the lamps needed to fulfill its prime contract with the Army and to supply Varo with the lamps which the latter needed to fulfill its contract with the Army. No distinction was made in the production process between lamps which Hanovia would ultimately supply directly to the Army and lamps which Hanovia would supply to Varo and the latter, in turn,

would furnish to the Army. At the outset of the production process, two lamps were subjected to the prescribed first-article tests and to the prescribed initial-production tests.

This was what the Government wished to have done in order to ensure that the lamps to be produced would comply in all respects with the requirements of the lamp specification, which called for a new sort of lamp not previously produced by any lamp manufacturer.

Lamps produced later in the production run were not first-article or initial-production lamps. Consequently, the subjection of such lamps to an additional series of first-article and initial-production tests not only would have failed to make "economic sense," as the Board said, but it also would have failed to comply with the requirements of Varo's contract with the Army, since the contract required that such tests be performed at the beginning of the production process, as was actually done.

If Hanovia derived some financial benefit from the circumstance that the first-article and initial-production tests which it performed on xenon lamps qualified such lamps both under its prime contract with the Army and under its subcontract with Varo, such benefit was not passed on to Varo in whole or in part and did not reduce Varo's costs. In this connection, see the discussion in the preceding part of this opinion.

In view of the foregoing discussion, it is not necessary to discuss a contention by the plaintiff that the contracting officer's action of July 17, 1969, in approving Varo's first-article and initial-production test report, based on Hanovia's testing of xenon lamps, precluded the successor contracting officer from demanding payment from Varo on the ground that required tests had not been performed, or a contention that the evidence in the administrative record does not provide substantial support for the Board's factual finding that it would have cost Varo $6,000 per lamp if Varo had performed (or caused to be performed) additional first-article and initial-production tests on five xenon lamps.

## CONCLUSION

The plaintiff's motions for summary judgment are allowed, the defendant's cross-motion for summary judgment is denied, and judgment is entered for the plaintiff in the sum of $37,118.16.

Syllabus

549 F. 2d 753

# KATHERINE CUNNINGHAM v. THE UNITED STATES

[No. 433–60. Decided January 26, 1977]*

ON THE PROOFS

**Civilian pay; suit for back pay for wrongful separation; correction of records; scope of review of Court of Claims; reinstatement request; measure of recovery.**—In *Cunningham* v. *United States*, 191 Ct. Cl. 471, 423 F. 2d 1379 (1970), this court *en banc* held that plaintiff had been illegally separated on June 12, 1959 from her civilian position with the Air Force, and ruled that she was entitled to back pay from said date to date of judgment, less applicable offsets, provided she prove that she was ready, willing and able to perform the duties of her former post at all times during the pay recovery period. On the basis of the evidence, the trial judge concluded that plaintiff was ready, willing and able to work since 1959 and that her failure to seek or obtain employment from 1967 to date so as to mitigate damages was justified. Although plaintiff objected to the judgment awarded in 1970 on the issue of liability because at all times an award of back pay for illegal separation has been subordinate to her goal to secure an official pronouncement by the court that the series of Army and Veterans Administration mental diagnoses from 1945 to 1955 were invalid, it is not within this court's jurisdiction to render such relief for the power to correct lies only in the Army and the Veterans Administration. Some 3½ months after the filing of the trial judge's opinion in February 1976 plaintiff moved for permission to make a "third amendment" to her original petition praying for reinstatement to her former Air Force position or to one of similar status. The court *holds* that the amendment is untimely and it is not allowed. Plaintiff is entitled to recover $57,182.75 representing back pay less offsets from June 12, 1959 to July 25, 1970, plus back pay and offsets from July 25, 1970 in an amount to be determined pursuant to Rule 131(c).

**Pleading and practice; implementation of judgments; reinstatement jurisdiction of Court of Claims.**

[1] Where plaintiff's proposed amendment to her original petition (i.e. reinstatement to her former position) did not relate to an issue developed at trial, as required by Rule 39(b), and since the court may grant leave to amend only when justice so requires or upon written consent of the adverse party, as provided in Rule 39(a), which consent was not forthcoming, under the circumstances that plaintiff waited 16 years from the filing of her original petition and

*Defendant's suggestion for rehearing *en banc* and motion for rehearing, and plaintiff's motion for rehearing *en banc* were denied April 1, 1977.

Syllabus

4 months after the filing in February 1976 of the trial judge's opinion to request the remedy of reinstatement (which she could have sought by way of mandatory or declaratory relief in the United States District Court for the District of Columbia as early as 1959 and in other district courts following enactment in 1962 of 28 U.S.C. § 1361), and that plaintiff was noticed by the clerk of this court in December 1972 of the court's reinstatement authority pursuant to Pub. L. 92–415 and was informed that a party, at the earliest practicable opportunity, may request the court to issue an order directing reinstatement, plaintiff's delay of 3½ years after notice in seeking the remedy of reinstatement is tardy beyond belief and justice does not require that the request be granted.

Courts ⊂⊃ 463

**Civilian pay; Civil Service retirement; disability retirement; Veterans Administraton v. Federal Employee's Compensation Act disability pay.**

[2] A finding of total disability by the Veterans Administration does not have the same preclusive effect on recovery of back pay for wrongful separation as a similar finding under the Federal Employees' Compensation Act. Under the latter, recipients of disability pay may not receive salary, pay, or remuneration of any type from the United States during the period in which they are paid disability compensation except in return for services actually performed.

Armed Services ⊂⊃ 104

**Civilian pay; Civil Service retirement; disability retirement; mental disability.**

[3] A diagnosis of mental disability constitutes an obstacle to securing employment, no matter how long it may have been in remission.

Armed Services ⊂⊃ 27

**Civilian pay; claim for back pay; ready, willing and able to work.**

[4] Before a federal employee may recover back pay for wrongful separation, she must show that she was ready, willing and able to perform the duties of the position from which she was removed for the period for which she seeks recovery. If a person who is illegally separated was able to discharge the duties of said position at the time of separation, and if thereafter she tries diligently but without success to obtain employment of that character due to circumstances for which the Government itself is in part responsible, then she has meet the burden of proving that she was ready, willing and able to work. If the claimant has lost some of her knowledge and skills requisite to discharging her former duties at work, this circumstance cannot properly be held against her. Ability to work relates only to one's innate physical or mental capacity, and not to the circumstance of whether a job is available.

United States ⊂⊃ 39(13)

Syllabus

**Civilian pay; recovery, measure of; other employment, obligation to seek; time spent in prosecuting appeals.**

[5] An illegally separated federal employee will not be denied her back salary for failure to work during periods when her time is reasonably consumed in prosecuting appeals from such separation.

United States ⇐ 39(8)

**Military pay; administrative remedies; Correction Board, resort to; when necessary.**

[6] Although resort to a Correction Board to correct a petitioner's records is a permissive rather than a mandatory remedy so that it does not toll the running of the statute of limitations from first accrual of the cause of action in this court, there are circumstances where recourse to the Board becomes a mandatory remedy which must be exhausted before judicial review is available, for instance where the Board is the only remedy open to the petitioner for purposes of eliminating references and findings in her records as to her mental or emotional condition. This court's scope of review would then be limited to the procedural regularity of the Board proceeding, rather than correction of actions which are purely within the discretionary prerogative of the military.

Courts ⇐ 460

**Court of Claims jurisdiction; veterans benefits; Veterans Administration diagnosis of physical or mental condition, review of.**

[7] This court has no jurisdiction to correct or change a Veterans Administration diagnosis of a claimant's mental condition, no matter how erroneous it may have been; its jurisdiction is to render a money judgment for back pay for wrongful separation. Veterans' benefits are considered to be gratuities, and establish no vested rights in the recipients, so that Congress is not obligated to provide a remedy through the courts but may provide only an administrative remedy.

Courts ⇐ 448

Constitutional Law ⇐ 103

**Civilian pay; recovery, measure of; Veterans Administration disability compensation, deductibility of.**

[8] Where the court has determined that plaintiff was wrongfully separated from her civilian position with the Air Force and entitled to back pay, the disability compensation she received from the Veterans Administration is not deductible as an offset from the amount of recovery.

Armed Services ⇐ 27

*Katherine Cunningham, pro se.*

*R. W. Koskinen*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SKELTON, KUNZIG, and BENNETT, *Judges.*

PER CURIAM: In *Cunningham* v. *United States*, 191 Ct. Cl. 471, 423 F. 2d 1379 (1970), this court *en banc* held that the plaintiff in this case had been illegally separated from her civilian position with the Air Force on June 12, 1959. The court ruled that she was entitled to back pay from the date of the wrongful severance to date of judgment, less applicable offsets. This ruling, of course, as in all such cases, implicitly mandated that she prove in a subsequent proceeding under Rule 131(c) that she was ready, willing, and able to perform the duties of her Air Force post at all times during the pay recovery period.[1] The proceeding to determine the amount of recovery was conducted in 1974. Plaintiff met her burden of proof and Trial Judge C. Murray Bernhardt determined the amount of back pay to which plaintiff was entitled from 1959 to July 25, 1970, in his opinion and findings filed February 10, 1976. The amount of recovery, less offsets, from July 25, 1970, to today's judgment was reserved for further proceedings under Rule 131(c). This case is now before the court on the exceptions and briefs of the parties to the trial judge's 1976 opinion. Upon consideration thereof, having heard oral argument, the court agrees with the trial judge's opinion and findings and adopts the same, with minor modifications, as the basis for its judgment in this case.[2] It is necessary, however, for the court to address one issue not raised before the trial judge.

On May 20, 1976, plaintiff moved for permission to make a "third amendment" to her original petition filed November 10, 1960. The amendment prayed, *inter alia*, for the reinstatement of plaintiff to her former Air Force position or to one of similar status.[3] The motion in support of the amend-

[1] The court amended its opinion by order on September 25, 1970, in a manner not relevant here.

[2] The trial judge's findings of fact, copies of which have been distributed to the parties, are not printed, however, as those essential to the decision appear in the opinion which follows.

[3] We reject and do not discuss certain other relief requested in the amendment as it is concluded that such is inappropriate in connection with this claim for back pay and, in any event, the amendment is voided for reasons which follow. It is noted that plaintiff has incorrectly captioned her motion and amendment as the third amendment. The plaintiff's amendments to her petition are as follows: (1) Mar. 6, 1961; (2) Nov. 23, 1965; (3) Jan. 16, 1974; and (4) June 4, 1976.

ment recited that the amendment would alter the prayer for relief "in order that it may encompass issues developed and supported by evidence adduced by reason of the trial held under Rule 131(c)." In other words, the amendment was said to be one to conform the pleadings to the evidence. Rule 39(b) authorizes such an amendment "when issues not raised by the pleadings are tried by express or implied consent of the parties." Upon this representation, the court allowed the motion on June 4, 1976. Defendant did not oppose, in fact did not even respond to, plaintiff's motion to amend.

Although plaintiff's motion appeared on its face to fall under Rule 39(b), in truth the prayer for reinstatement as shown in the amendment itself did not relate to any matter developed at trial. The new prayer was, instead, a request for additional relief, first set forth some 4 years after this court was granted reinstatement authority, *see* Pub. L. 92–415, now codified as 28 U.S.C. § 1491 (Supp. V, 1975), and some 16 years after plaintiff began her proceeding in this court on November 10, 1960. As an amendment sought totally apart from developments in the proof, plaintiff's May 20 motion falls not under Rule 39(b), as her statement of reasons for the motion suggested, but under Rule 39(a). The amendment itself cites both Rules 39(a) and 39(b). The standards of neither rule, however, permit the motion to succeed. The June 4, 1976, allowance, issued on erroneous representations, must be treated as void and improvidently issued.

Rule 39(a) provides that, after the initial pleading period, "a party may amend his pleading (1) by leave of court (which shall be freely given when justice so requires), or (2) by written consent of the adverse party." Defendant has not consented in writing to plaintiff's amendment. The first standard therefore governs, requiring leave of court to amend the pleadings. The court's permission is to be given freely, according to the rule, but with the qualification that it is to be given freely "when justice so requires." The viability of plaintiffs May 20 motion rests squarely on whether justice requires that she be allowed to amend her pleadings in 1976 to add a prayer for reinstatement. Such a determination is left to the court's discretion. It is obvious to us that considerations of fairness and substantial justice to both parties

not only do not require that permission to amend be given, but to the contrary counsel against allowance of the motion. Plaintiff has waited 16 years from the filing of her original petition in this court to ask for the remedy of reinstatement. She could have sought mandatory or declaratory relief in this vein from the United States District Court for the District of Columbia as early as mid-1959, *Levine* v. *Farley*, 107 F. 2d 186 (D.C. Cir. 1939), and from federal district courts sited elsewhere following enactment of 28 U.S.C. § 1361 (1970) in 1962. *See Chaudoin* v. *Atkinson*, 494 F. 2d 1323 (3d Cir. 1974). She could have requested reinstatement from this court beginning in late 1972, after the enactment of Pub. L. 92–415 on August 29, 1972. Plaintiff never sought to invoke the district court's aid, however, and delayed submitting her prayer to this court until 4 months after the filing of the trial judge's opinion in February of 1976. Interestingly, plaintiff's motion to amend arose only after the trial judge observed in his opinion, printed *infra*, that "[t]here is no express prayer for reinstatement."

At oral argument, plaintiff was questioned by the court regarding this delay. She responded that she did not know that a request for reinstatement should have been made prior to the time that she convinced the court—presumably meaning the trial judge—that she was entitled to full back pay to the present date. Ignorance of rights and procedural rules may sometimes be forgiven a *pro se* claimant, as plaintiff now is, but other facts reveal her explanation of delay to be merely a lame excuse. Although plaintiff is presently conducting her case alone, she has had the assistance of four legal counsel at various times during the odyssey of her case. Since filing her petition she has worked as a legal secretary for four large law firms and is not unacquainted with law and lawyers and how to get legal advice. The trial judge describes plaintiff as "exceptionally intelligent." Further, when the court first received authority from Congress to order reinstatement, the clerk of the court sent written notice of this development to all claimants with cases then pending in the court, including of course the present plaintiff. The notice sent forth, styled "General Order No. 3 of 1972," 200 Ct. Cl. xxvii, dated December 12, 1972, recited that "[a]ny

party may request that the court issue * * * an order directing restoration to office or position * * *," that "[i]n any case pending on the date of this order in which [such] relief * * * is sought, the nature of the order desired shall be specified in such pleading as may be allowed in accordance with the provisions of Rule 39," and that "any request for [such] relief * * * shall be made at the earliest practicable opportunity." Plaintiff was thus on written notice that she could and should promptly amend her pleadings under Rule 39 to ask for reinstatement. Plaintiff's delay of 3½ years after notice, in seeking reinstatement from this court, and her much greater delay in seeking help from the district court, remain unexplained and unexcused. Her May 20 motion smacks of afterthought, and justice does not require that it be allowed. Plaintiff has had quite long enough to formulate in her own mind the relief that she wants from this court. Her amendment praying for reinstatement is tardy beyond belief, and cannot now be permitted.

Since we have decided to read the pleadings absent the amendment requesting reinstatement, and since no findings were requested or made about it or proof adduced thereon which might justify amending the petition to conform to the evidence, nor does justice require it, no relief will be forthcoming beyond the payment of sums that have been or will be found properly owing in proceedings under Rule 131(c) to date of this judgment.

OPINION OF THE TRIAL JUDGE

BERNHARDT, *Trial Judge:* In April 1970 it was determined that plaintiff was entitled to judgment of back pay for procedurally improper separation in 1959 from her civilian position in the Air Force. 191 Ct. Cl. 471, 423 F. 2d 1379 (1970). The amount of recovery was remanded to the trial division for ascertainment. The Comptroller General has computed, without dispute, the amount of back pay due plaintiff to July 25, 1970, and the deductions therefrom for lump sum terminal leave payment, contributions to the Civil Service Retirement Fund, and premiums for Federal Government Life Insurance. Disputed issues remaining include principally the following: (1) whether plaintiff has been ready,

willing and able to work since 1959; (2) whether her failure to seek or obtain employment from 1967 to date so as to mitigate damages was justified; (3) whether the 100-percent disability compensation she has received from the Veterans Administration (hereafter VA) from 1959 to date should be credited against her recovery. In addition, plaintiff wants the court to repudiate and declare invalid various diagnoses of mental illness by the Army in 1945 and by the VA from 1954 to 1970, upon which latter her 100-percent disability compensation rating is predicated.

So that these issues might be considered in their proper context, highlights of the record are summarized, starting with plaintiff's service in the Army where for present purposes her official medical history in the Government originated:

*1944–45:* Served as private in Women's Army Corps from August 7, 1944 to April 30, 1945. Hospitalized at three successive Army hospitals from February until April 30, 1945, with initial complaint of pneumonia. Honorably—albeit involuntarily—discharged on April 30, 1945, on a Certificate of Disability for psychoneurosis classified as "anxiety hysteria, severe", having been admitted to the last hospital for psychosis, schizophrenic reaction type, but not found to be psychotic. Plaintiff's challenge of the discharge on factual and legal bases is now pending before the Army Correction Board for determination, but suspended there awaiting disposition of the instant case.

*1945–48:* Original rating of 30-percent disability by VA for service aggravation of "psychoneurosis, anxiety, considerable social and industrial incapacity", reversed on appeal because condition of "psychoneurosis, mixed type" was found to have preexisted service and was not service aggravated, but ultimately reinstated by VA Board of Veterans Appeals July 30, 1948, with rating reduced to 10 percent from August 30, 1946, for service aggravated "psychoneurosis, mixed type."

*May 1937–August 1954:* Continuously employed, except for brief periods of unemployment 1945, 1947, and 1952, 8 months plus in Women's Army Corps 1944–45, and periods as student.

*August 1954–December 1954:* Employed by Boeing Airplane Company as mathematician. Leave of absence from Boeing on December 9, 1954, to enter VA hospital.

*December 1954–April 1956:* Three separate periods of hospitalization in VA hospital in Seattle, resulting in several "impressions" and/or "diagnoses" of "schizophrenic reaction, paranoid type", a psychosis as opposed to a psychoneurosis, the difference being a mental disease versus a behavioral problem. These impressions and/or diagnoses plaintiff challenges as factually and procedurally erroneous.

*May–June 1955:* In May 1955 VA proposed to end plaintiff's disability compensation because the true diagnosis was said to be a nonratable "inadequate personality" instead of the prior diagnosis of psychosis, which latter was recommended to be held erroneous. In June 1955 the VA Central Office disagreed with the recommendation, and diagnosed plaintiff instead as service-connected "conversion reaction", stated to be a character and behavior disorder and not a psychosis or a neurosis. VA Regional Office was accordingly instructed that plaintiff's service connection for neuropsychiatric disorder not be disturbed.

*September 1955:* Despite the instruction of the VA Central Office in June 1955 noted in the preceding paragraph, in September 1955 the plaintiff's VA disability rating was increased to 100 percent, effective retroactively to December 10, 1954, for a condition identified as "conversion reaction—now diagnosed schizophrenic reaction, paranoid type", a psychosis, on the basis of an April 1955 final diagnosis by the Seattle VA Hospital. The plaintiff contends, with considerable authority, that in changing the diagnosis the VA failed to comply with procedures for such a change which are made mandatory by certain VA regulations which she cites. Plaintiff has retained the 100-percent rating to date.

*June 1956:* Plaintiff's VA 100-percent rating confirmed and continued, based upon plaintiff's renewed hospitalization at Seattle VA Hospital, and resultant diagnosis. The official VA Central Office conflicting diagnosis in June 1955 referred to above was apparently ignored.

*July 1956–June 1959:* After medical clearance, and with full knowledge of her 100-percent VA disability rating,

plaintiff was hired as a mathematician by the Wright Air Development Center (an Air Force installation) in July 1956 and remained there until June 1959, when her resignation was accepted despite her prompt retraction. This is the separation declared procedurally defective by the court in 1970.

*June 1958:* In June 1958, while plaintiff was employed as a mathematician at WADC, her VA rating of 100-percent disability for schizophrenia, paranoid type, was confirmed and continued, based upon a VA examination in May 1958. This diagnosis is also attacked by plaintiff as being factually and procedurally erroneous.

*1959–67:* After exhausting all possibilities of obtaining employment as a mathematician following separation from WADC in 1959, plaintiff was employed as a secretary in six successive offices in Washington, D.C.

*June 1967 to date:* Unemployed.

It is clearly the plaintiff's burden to prove that she was ready, willing and able to discharge the duties of the position from which she was illegally separated in 1959, before she can recover back pay. *Manzi* v. *United States*, 198 Ct. Cl. 489, 493 (1972); *Everett* v. *United States*, 169 Ct. Cl. 11, 340 F. 2d 352 (1965); *Keith* v. *United States*, 174 Ct. Cl. 284, 290 (1966); *Seebach* v. *United States*, 182 Ct. Cl. 342, 353 (1968); *Urbina* v. *United States*, 192 Ct. Cl. 875, 886, 428 F. 2d 1280, 1287 (1970); *Walker* v. *United States*, 179 Ct. Cl. 723 (1967), *cert. denied*, 389 U.S. 1036 (1968). The defendant contends that plaintiff's receipt of 100-percent disability compensation from the VA since prior to 1959 to this time automatically establishes that she was not able to discharge the duties of the position from which she was separated. The defendant also relies on the expert testimony of Dr. Russell Martin, a board-certified VA psychiatrist who, on the basis of his examination of plaintiff in December 1970, testified that she was unemployable in any capacity at that time because of her diagnosis of "paranoid schizophrenia, in remission." Plaintiff meets these contentions with the fact that she was employed almost continuously in a secretarial capacity from 1959 to 1967, and with the expert testimony of Mr. John H. Hoffman, a highly qualified clinical psychologist, who testified that plaintiff never suffered from either a psychosis or even a neurosis

while she was employed as a Government mathematician at Wright Air Development Center (WADC) from 1956 to 1959, that there was no question of plaintiff's readiness, willingness and ability to discharge her duties as a mathematician at WADC despite the fact that throughout that period she was officially diagnosed as 100 percent mentally disabled by the VA for compensation purposes, and that from his observation of plaintiff's conduct of her own trial as a *pro se* plaintiff she was completely sane. We shall consider these various contentions in detail.

The VA informed the court by letter in 1973 that a disability rating assigned a veteran represents the average impairment of earning capacity which that disability would cause in civil occupations generally, and does not necessarily represent the reduction in earning capacity which a specific veteran may have suffered as the result of his disability. The VA advised that many veterans are able to overcome the handicap of their disability and earn substantial wages in private or Government employment while they continue to be paid disability compensation. Unlike 38 U.S.C. §§ 301 *et seq.* (1970), which does not by its terms preclude receipt of VA disability compensation by a veteran earning a salary for services rendered, by analogy section 7 of the Federal Employees' Compensation Act of 1916, *as amended*, 5 U.S.C. § 8116(a) (Supp. V, 1975), provides that recipients of disability pay under that Act may not receive salary, pay, or remunerations of any type from the United States for the same period except in return for services actually performed. The grant of total disability under FECA is premised on the agency's determination of the total and complete disability of the recipient to perform his normal work, so the claimant's receipt of total disability compensation under FECA automatically establishes his inability to work for the purpose of precluding his recovery of back pay for wrongful discharge, unless he can establish that the agency's determination of total disability was clearly wrong. *Graves* v. *United States*, 176 Ct. Cl. 68 (1966); *Everett* v. *United States*, *supra*. Obviously a finding of total disability by the VA does not have the same preclusive effect on recovery of back pay for wrongful discharge as a similar finding under FECA, primarily

because of the terms of the latter. Defendant's premise that plaintiff's receipt of 100-percent disability compensation from VA establishes *ipso facto* her inability to work since 1959 is without merit.

We next consider the testimony of defendant's expert psychiatrist, Dr. Russell Martin. Dr. Martin personally examined plaintiff in December 1970 for approximately one hour, after a study of one hour or less of limited parts of plaintiff's voluminous medical record in the VA, arrived at the "impression" of "paranoid schizophrenia, in remission", and concluded that plaintiff's paranoid personality characteristics rendered her unemployable in any capacity at the time of the examination. He found no over psychosis present at that time, nor in fact since 1955, including the 3-year period of her employment by WADC from 1956 to 1959. Since he found plaintiff at the time of his examination to be alert, coherent, with clear train of thought, etc., his ultimate impression of psychosis was based entirely on five interim and final summaries by the Seattle VA Hospital in 1954 through 1956 (the only parts of the VA medical record he consulted), plus information supplied him by plaintiff concerning her erratic record of private employment from 1959 to 1967. Had he not known of plaintiff's VA medical history, but only of her private employment history following 1959, Dr. Martin said that he would have diagnosed her as "paranoid personality" rather than "paranoid schizophrenia, in remission." Had he known neither of plaintiff's medical record nor of her private employment history after 1959, he would have found nothing wrong with her on the basis of his examination in 1970. Dr. Martin found no active psychosis to exist when he examined plaintiff in 1970. In assessing plaintiff's record of frequent job changes from 1959 to 1967, Dr. Martin relied exclusively for his information on plaintiff's description of it to him, and did not refer the matter for investigation and report to the Social Work Service facility of the VA, as he could have done. Since the fault or reason for plaintiff's series of private job terminations after 1959 was indeterminate from the record, yet was so instrumental in Dr. Martin's diagnosis, it would have behooved Dr. Martin to have referred the matter to the Social Work Service of VA for investigation and report. Nor did

Dr. Martin enlist the services of the VA Clinical Psychology Department for testing the presence of pathological symptoms in the plaintiff, as he could have done. While employing these available VA facilities is discretionary with the examining psychiatrist, in view of the extraordinary history of this litigation, it would have been the better part of discretion for Dr. Martin to have done so, particularly since his own examination was brief, and as persuasively presented by plaintiff the medical records upon which he relied were suspect in their validity and incomplete in their substance.

In challenging Dr. Martin's diagnosis plaintiff has gone to great lengths to itemize the respects in which Dr. Martin's diagnostic evaluation failed to comply with the requirements specified in the Physician's Guide, Disability Evaluation Examinations, published in June 1963 by the VA Department of Medicine and Surgery for the information and guidance of physicians performing examinations for VA compensation, pension, and insurance purposes. For these reasons, although Dr. Martin was well-qualified to assess plaintiff's mental condition with respect to her employability since 1959, it is not believed that he devoted the time or engaged the available VA resources sufficiently to justify complete reliance on his professional judgment in this instance.

In direct contradiction to the views of defendant's Dr. Martin is the testimony of Mr. John H. Hoffman, who for the entire period of plaintiff's employment at WADC from 1956 to 1959, and for many years preceding and following that chapter of this record, was a certified clinical psychologist serving as the Chief of the Mental Hygiene Section, Federal Civilian Employees Health Service Branch at WADC. In this capacity Mr. Hoffman was consultant in psychology to the medical member of the Board of United States Civil Service Examiners for the Civil Service Commission facility at WADC. With full knowledge of plaintiff's medical history in the Army and VA, Mr. Hoffman, after examining her on the basis of clinical psychological tests which he conducted, passed upon the psychological aspects of her application for employment by WADC, and certified that she was psychologically capable of discharging her prospective duties as a mathematician at WADC. In

this connection he was familiar with Sec. 5-2a of Subchapter 5, Federal Personnel Manual, which provides that "as a general rule, a history of mental illness is not disqualifying for Federal employment provided that recovery has been certified by competent medical authority and the applicants are capable of performing the duties of the position without hazard to themselves or others."

During the plaintiff's first probationary year of employment at WADC, Mr. Hoffman received periodic reports from plaintiff's supervisors which were entirely favorable to her, with no derogatory information whatsoever. These favorable reports were corroborated by the plaintiff's periodic efficiency reports which were uniformly "satisfactory." This record of official satisfaction with plaintiff's performance at WADC is diametrically inconsistent with other evidence from plaintiff's superiors, portraying plaintiff as a constant trouble-maker who caused repeated management disruptions by her charges of discrimination, and who was moved from job to job. If these latter facts were true it is remarkable that they were not brought to the attention of Mr. Hoffman. Despite the contradictions, it is concluded that the *official* record does not establish that plaintiff was not mentally or technically qualified to perform her duties as a mathematician during her 3 years at WADC. In fact, Mr. Hoffman testified that even if the derogatory record of plaintiff's employment at WADC as reported by her superiors was correct it would not alter his conclusion that plaintiff was suffering from neither a psychosis nor a neurosis. He diagnosed plaintiff at the outset of her employment at WADC as "psychoneurosis, mixed, chronic, mild" (a relatively mild form of behavior disturbance), but he later found that even this diagnosis was not appropriate and could not be sustained. It was his belief that it would be difficult for a person burdened with a diagnosis of schizophrenia reaction, paranoid type, known to others, to lead a life with normal relationships, particularly in the area of employment. Nor would he be surprised that plaintiff, having been denied employment in her field of mathematics because of her VA diagnosis of psychosis (as she was denied on numerous occasions in seeking jobs in that field) would have her record of going from one secretarial job to another from 1959 to 1967.

The court has had at least two occasions to consider the effect of a mental disability diagnosis on an individual's chances of securing employment. In *Scroggins* v. *United States*, 184 Ct. Cl. 530, 397 F. 2d 295, *cert. denied*, 393 U.S. 952 (1968), the majority rejected plaintiff's contention that a disability retirement for psychiatric reasons is a "badge of infamy." However, Judge Skelton's concurrence at 541 stated that such a retirement creates a stigma against the employee "that can never be outgrown nor overcome", and "[c]ertainly no government agency would likely hire an employee who had been so retired, and it is unlikely any other employer with desirable employment would do so." In *Davis* v. *United States*, 181 Ct. Cl. 1095 (1967), the court said in the findings at 1124 that plaintiff's efforts to improve his post-discharge job status by seeking employment elsewhere "were frustrated (1) by his history of mental illness and (2) by his consequent inability to obtain clearance for secret work." If the "cloud of her discharge [for glaucoma] * * * thwarted" plaintiff at every turn in her effort to get work during a period of unlawful separation, as in *Keith* v. *United States*, *supra*, a diagnosis of insanity constitutes a much more insuperable obstacle, no matter how long it may have been in remission. A leading psychiatric authority, Dr. Karl Menninger, in a paper entitled "The Unitary Concept of Mental Illness" published in The Bulletin of the Menninger Clinic, stated that the "word schizophrenia becomes a damning designation. To have it once applied to a young man can be to ruin a career, despite all evidence of subsequent healthiness."

Certainly the plaintiff found that her VA diagnosis of mental illness emphatically impeded her efforts to secure a job as a mathematician. Immediately after her VA diagnosis in 1955 plaintiff filed many applications with American companies for employment as a mathematician, and despite her good technical credentials, a shortage of mathematicians, and initially favorable reception of her applications, she was unable to secure a job once the prospective employer learned of her readily available medical history. Eventually she was hired by WADC in 1956 as previously stated after being cleared by Mr. Hoffman, their clinical psychologist. During her employment at WADC she made at least four applica-

tions for employment as a mathematician to research organizations in the Navy and Air Force, with no results, more than likely due to their ready access to her medical history. Following plaintiff's separation from WADC in 1959 she again filed numerous applications for employment as a mathematician with defense type corporations, some of which responded encouragingly until her medical background became known. In one case her hiring by General Motors Corporation was rescinded when they apparently learned of her mental illness. In desperation she sought secretarial work through employment agencies, both public and private, and was not successful, including a rejection for secretarial employment by an Air Force base in Ohio.

Finally, plaintiff came to Washington, D.C., to seek a secretarial job, and from December 1, 1959 to June 1967 held a series of six secretarial jobs, usually in law firms. In this 8-year period of 1959–67 plaintiff was unemployed for a total of approximately 11 months between jobs. About half of her 8 years of private employment was with one employer, which was the only one where no questionable circumstances attended her departure. In each of the others some incident involving a clash of personalities precipitated her resignation or discharge. The facts of record are insufficient to establish the justification for her terminations. There were no complaints concerning her technical capacity, for plaintiff is an exceptionally intelligent person. She feels that her terminations were due to knowledge gained by her employers of her medical history, but proof leaves this assumption speculative.

To the defendant this record of plaintiff's private employment from 1959 to 1967 proves that she was unemployable, in that she was unable to hold a job. To the plaintiff her employment during that time proves just the contrary, that she was able to work, and the fact that she was unable to find work comparable to the position from which she was discharged cannot be held against her, for her medical record prevented it. In *Manzi* v. *United States*, *supra*, the court held at 493 that the claimant must show "that he was ready, willing and able to perform the duties of the position from which he was removed for the period for which he seeks recovery."

As long ago as *Nicholas* v. *United States*, 53 Ct. Cl. 463 (1918), *aff'd*, 257 U.S. 71 (1921), it was held that a claimant must "show affirmatively his willingness and ability to discharge the duties of the office in question from the date of his removal down to the present time." However, in *Keith* v. *United States*, *supra*, it was stated at 290 that, if the plaintiff is able to work but cannot get work due to no fault of her own, she has met her burden of proof. As a logical extension, if a person who is illegally separated from her Government job was able to discharge the duties of the position from which she was separated at the time of the separation, and if thereafter she tries diligently but without success to obtain employment of that character due to circumstances for which the Government itself is in part responsible, then she has met the burden of proving that she was ready, willing, and able to work. It is not known whether at this late date the plaintiff retains the knowledge and mathematical skills requisite to discharging her former duties at WADC, but if not this circumstance cannot properly be held against her.

In the *Keith* case, *supra*, where the defendant failed to show that plaintiff was physically unable to perform her duties in the period between her improper discharge and her reinstatement for which she sought recovery, in commenting on the plaintiff's ability to work, the court said at 289 of the opinion that the "fact is that she has shown [by performance of duties following reinstatement] that those disabilities, such as they are, do not prevent her working." Similarly in plaintiff's situation, the fact that she was gainfully employed as a secretary from 1959 to 1967 demonstrates that she was able to work and support herself, albeit she did not work as a professional mathematician for reasons apart from her ability to do so if she could have found a job. "Ability to work" relates only to one's innate physical or mental capacity, and not to the circumstance of whether a job is available.

Summing up, the plaintiff's record of almost constant employment from 1956 to 1967 as a mathematician at WADC for 3 years, and as a legal secretary thereafter, during all of which period she was drawing 100-percent VA disability compensation based on a diagnosis of psychosis, plus the fact that whatever mental condition she had has been inactive and

in remission for over 20 years, the conflicting views of Dr. Martin and Mr. Hoffman as to her employability, the substantial conflicts in her diagnoses within the VA itself, the serious questions which exist as to the regularity of the diagnoses of mental incompetence by the VA, and the able manner in which the plaintiff has represented herself in this complex case ever since its inception in 1960, lead to the unavoidable conclusion that from her separation at WADC in June 1959 to her last employment in June 1967 the plaintiff has shown herself to be ready, willing, and able to work in some gainful occupation. Since her ability to perform duties as a mathematician at WADC existed at the time of her separation therefrom, there is a presumption in the absence of evidence to the contrary that those abilities remain, diminished though they may be through a desuetude not fairly chargeable to plaintiff.

From 1967 to the rendition of this court's opinion on the liability issue in April 1970 the plaintiff's time was occupied with the preparation of requested findings and briefs following a trial in March 1967, preparation of brief and exceptions to the report of the trial judge, several discovery motions, and a motion for summary judgment which was allowed. From April 1970 to date the plaintiff's time has been fully consumed in the preparation of literally dozens of discovery motions, pretrial conferences, preparation for trial, trial in June 1974, and preparation of voluminous requested findings and briefs. The Government, which steadfastly resisted plaintiff's efforts for many years to gain access to all of her medical records on the grounds that their production would be injurious to her mental health, finally gave in after the court granted a series of plaintiff's discovery motions in 1970 and 1971, and thereafter reluctantly capitulated in meeting plaintiff's numerous demands for additional records which had not hitherto been produced, to the end that at this time it is safe to say that the Government has furnished plaintiff all of the records which it has been able to find. Incidentally, their disclosure to plaintiff has not had any deleterious consequences to her health as the Government had feared, so far as is known.

All of this has taken an enormous amount of plaintiff's time. One need only examine the many pages of the court's docket book to appreciate the extent of plaintiff's personal involvement. While for certain periods she was represented by counsel of record, there is reason to believe that plaintiff herself was responsible for virtually all of the paperwork, research, legal strategy, discovery, and presentation at trial. It is questionable whether plaintiff, even if financially able to do so, could have found counsel willing or able to spend the time required to duplicate her own efforts. It is true that much of the effort has been expended unproductively in connection with the elaborate reconstruction of her records in the Army and VA in order to expunge or edit them, but as a nonlawyer the plaintiff cannot be expected to exercise legal discernment as to relevant evidence, to fully comprehend jurisdictional limits, or to conduct her litigation as efficiently as one trained in the law.

In *Urbina* v. *United States*, *supra*, it was said at 886 of the opinion: "An illegally discharged employee will not be denied his back salary for failure to work during periods when his time is reasonably consumed in prosecuting appeals from such discharge." In *Schwartz* v. *United States*, 149 Ct. Cl. 145, 181 F. Supp. 408 (1960), during the period from plaintiff's suspension and subsequent reinstatement plaintiff admittedly made no effort to secure employment. The court excused him from his failure while he was preparing for his administrative hearing following his suspension and while he was awaiting a decision on his appeal, but not thereafter. It is abundantly clear in the case under consideration that plaintiff was, in fact, fully occupied in the prosecution of her case in this court at least since June 1967. Had she been employed since 1967 she would have been physically unable to perform all the duties the case has entailed. Therefore, from June 1967 to the present time she is entitled to the back pay for the position from which she was separated, and is exempt from the normal requirement of mitigating damages by seeking gainful employment in that period because she has proven that her time was reasonably consumed in prosecuting her case.

Paradoxically, the plaintiff objected to the judgment awarded her by the court in 1970 on the issue of liability because at all times an award of back pay for illegal separation has been distinctly subordinate in her wants. Her overriding goal in this litigation is and always has been to secure an official pronouncement by the court that the series of Army and VA mental diagnoses from 1945 to 1955 were invalid. She is particularly concerned over the subsisting VA diagnosis of "schizophrenic reaction, paranoid type", a pathological psychosis—in short, insanity—because it has permanently blighted her professional career as a mathematician and has made her a social outcast. If in fact the plaintiff was wronged in these diagnoses we can only sympathize with her plight, but even so would be powerless to render the relief she demands, for the power to correct lies only in the source, namely, the Army and the VA.

To this end there is pending before the Army Board for Correction of Military Records plaintiff's application filed in January 1973, demanding that her Army medical, service, and discharge records be corrected to eliminate all references and findings as to her mental or emotional condition on the grounds of factual and procedural errors. The Board proceeding has been suspended awaiting the conclusion in this case. The authority of the Board derives from 10 U.S.C. § 1552 (1970), as implemented by regulations, 32 C.F.R. § 581.3 (1976), under which the Secretary of the Army, acting through a board of appointed civilians, may correct any Army military record when necessary "to correct an error or remove an injustice." The scope of authority is broad. It does not, of course, embrace the correction of VA records. There is no express sanction against judicial review. Although resort to the Board has been considered to be a permissive rather than a mandatory remedy so that it does not toll the running of the statute of limitations from first accrual of the cause of action (*O'Callahan* v. *United States*, 196 Ct. Cl. 556, 451 F. 2d 1390 (1971); *Rynerson* v. *United States*, 202 Ct. Cl. 1095 (1973), *cert. denied*, 415 U.S. 995 (1974); *Artis* v. *United States*, 205 Ct. Cl. 732, 506 F. 2d 1387 (1974)), there are circumstances where recourse to the Board

becomes a mandatory remedy which must be exhausted before judicial review is available. *Friedman* v. *United States*, 159 Ct. Cl. 1, 18–19, 310 F. 2d 381, 392–93 (1962), *cert. denied*, *sub nom. Lipp* v. *United States*, 373 U.S. 932 (1963). This is such a case. At this stage the Board is the only remedy open to plaintiff for the purpose she seeks, namely, to correct her military records, and must be exhausted before this or any court can review the procedural regularity of final Army action. Even then the scope of review would be limited to the procedural regularity of the Board proceeding, rather than correction of actions which are purely within the discretionary prerogative of the Army. For the benefit of the Board it can be said that our careful review of the wealth of exhibits and regulations in the context of plaintiff's extensive findings and briefs justifies the conclusion that the plaintiff's contentions are not frivolous.

The plaintiff's demand that the court revise and correct the VA diagnosis of her mental condition because of factual and procedural errors and violations is completely beyond our jurisdiction. The statute, 38 U.S.C. § 211(a) (1970), makes decisions of the VA on any question of law or fact concerning a claim for benefits or payments final and conclusive and not subject to judicial review, with certain exceptions not here pertinent. Veterans' benefits are considered to be gratuities, and establish no vested rights in the recipients, so that Congress is not obligated to provide a remedy through the courts but may provide only an administrative remedy. *Milliken* v. *Gleason*, 332 F. 2d 122 (1st Cir. 1964), *cert. denied*, 379 U.S. 1002 (1965). The federal courts (*Brown* v. *United States*, 150 Ct. Cl. 836 (1960)) have overwhelmingly applied the statute to preclude review, almost always with reference to decisions of the VA on claims for disability compensation. The plaintiff's disability compensation is at the maximum of 100 percent, so her claim is not the usual one to award her compensation or to increase it, but by indirection to decrease or eliminate it if she were to succeed in her efforts to erase or modify the VA diagnosis of psychosis upon which her disability rating is predicated. This court has no jurisdiction to

correct or change the VA diagnosis, no matter how erroneous it may have been; its sole jurisdiction is to render a money judgment. The money judgment sought here is for back pay for wrongful separation from plaintiff's civilian job in the Air Force. It is not for VA disability compensation, so even if the statute were not to preclude judicial review of VA decisions on a veteran's entitlement to disability compensation there would be no nexus upon which the court, in exercising its power to enter a money judgment, could implement that award by correcting the administrative record upon which the award of money judgment must rest, since the demand is not to alter the VA disability compensation.

We are uninformed by the record as to whether the VA has a formal procedure comparable to the Army's Correction Board designed to correct errors in past VA medical diagnoses, other than its duty to make periodic examinations of beneficiaries to adjust their disability rating according to fluctuating physical conditions. If the VA were to have such a procedure, certainly the record which the plaintiff has advanced to the court would justify a restudy in depth of plaintiff's contentions, for as in the case of the plaintiff's contentions concerning the correction of her Army record, her representations as to her VA diagnoses are not without prima facie appeal. In her insistence on the correction of her VA diagnoses—a demand we cannot redress—plaintiff places at serious risk the valuable disability compensation she has been receiving. Her quixotic compulsion to jeopardize that in exchange for a clean bill of health is beyond the writ of this court.

As for the arithmetic of plaintiff's recovery, the following schedule reflects to and including July 25, 1970, and without consideration of tax liability, an amount due her of $57,182.75:[1]

[1] From December 10, 1954 through July 31, 1974, the plaintiff received $70,812 in VA disability compensation, none of which is deductible from her recovery. She now receives such tax free compensation in the monthly amount of $655, which is equivalent to an annual wage of about $9,235 before federal income tax at the 1975 rates, assuming no other income, one personal exemption, and the use of the standard deduction.

Syllabus

| | | |
|---|---|---|
| Gross Salary—June 12, 1959–July 25, 1970 | | $106, 165. 20 |
| Less: | | |
| Terminal Leave | $332. 00 | |
| CSC Retirement | 6, 942. 33 | |
| Federal Life Insurance | 778. 98 | 8, 053. 31 |
| | | $98, 111. 89 |
| Credits: | | |
| Gross Civilian Earnings to June 20, 1967 | 39, 276. 14 | |
| Unemployment Compensation | 1, 653. 00 | 40, 929. 14 |
| Net to July 25, 1970 | | $57, 182. 75 |

The plaintiff is also entitled to recover back pay from July 25, 1970, in an amount to be determined pursuant to Rule 131(c).[2]

CONCLUSION

Plaintiff is entitled to recover the sum of $57,182.75, representing back pay less offsets from June 12, 1959 to July 25, 1970, plus back pay and offsets from July 25, 1970, in an amount to be determined pursuant to Rule 131(c).

---

548 F. 2d 343

## JUAN M. HUERTA v. THE UNITED STATES

[No. 110–69. Decided January 26, 1977. Plaintiff's suggestion for rehearing *en banc* and motion for rehearing denied March 4, 1977.]*

ON THE PROOFS

**Contracts; breach; taking; burden of proof; demolition contracts at Guantanamo Naval base; loss of salvaged materials.**—In 1956–1963 plaintiff, a Cuban national until his American naturalization in 1974, and his brother conducted a large demolition, salvage and construction materials business in Santiago, Cuba. During 1960–1962 plaintiff was awarded and performed five demolition contracts on the U.S. Naval base at Guantanamo, taking as the principal consideration for his work title to all materials salvaged from the demolished structures which, as under previous contracts, he planned

[2] On January 16, 1974, the petition was amended to demand back pay and accumulated leave "and for such other and further relief as the Court may deem just and proper." There is no express prayer for reinstatement.

*On June 1, 1977 plaintiff filed a petition for a writ of certiorari.

to remove and resell in Santiago. However, due to the advent of the Castro regime in Cuba and its programs beginning in 1960 of state ownership and directions of major, basic business enterprises, the materials salvaged from the five contracts remained on a site at the base made available by the Navy as an accommodation. Furthermore, President Kennedy's 1962 embargo on Cuban-American trade impeded the movement of shipments from Guantanamo to Cuba. Having failed to receive any economic benefit from the salvaged materials which he contends are now valueless, plaintiff claims that the United States (1) breached the contracts when Navy officials refused his requests for permission to take the materials into Cuba, depriving him of the principal consideration for the contracts, violating an implied covenant of cooperation, or effecting a cardinal change order; (2) took his property without compensation when it refused to grant his requests to remove it; and (3) took his property without compensation when the stored materials were allegedly pilfered by agents of the United States and used in the building of base structures. Defendant asserts that plaintiff never requested permission to take the materials into Cuba, that he elected not to take the property there because it would be expropriated by Cuba, as was his business in Santiago, and that there was no appropriation of the property for public use by defendant or its agents. Upon review of the evidence adduced at trial, it is *held* that plaintiff has failed to establish he ever made a request to anyone in authority for permission to remove his salvaged materials to Cuba; instead, the evidence compels the conclusion that plaintiff elected to retain the property at the storage base rather than ship it to Cuba and risk its loss there. It is also *held* that plaintiff has not established by any credible evidence that removal or pilferage of his property by persons on the base, nor the identity of the alleged pilferers as agents of defendant, nor the use of any allegedly pilfered property in Government structures, nor the authority for any such appropriation or use. Additional issues relating to jurisdiction, releases, and the statute of limitations are, therefore, not reached. Accordingly, plaintiff is not entitled to recover on any of his three stated grounds and the petition is dismissed.

**Contracts; breach; burden of proof.**

[1] Before a plaintiff may recover for breach of contract, it must establish that the Government's conduct was wrongful. Thus, although plaintiff claims that the Government breached the subject contracts for performance of demolition contracts by refusing plaintiff's requests for permission to remove his salvaged materials from Guantanamo Naval base to Cuba, since plaintiff has failed to establish that he ever made any such requests to any Government authority, and since breach would depend on requests wrongfully refused, the claim of breach of contract is unsupported.

Per Curiam

**Sovereign act; effect of on rights and liabilities of parties.**

[2] Acts of the Federal Government which are of a general and public character, such as the 1960 Commerce Department export ban and the 1962 trade embargo with Cuba, are acts of the sovereign which do not establish liability for breach of contract or for a Fifth Amendment taking of private property.

United States ⟸ 73(22)
Eminent Domain ⟸ 2(1)

**Eminent domain; taking; what constitutes.**

[3] The concept of a "taking" of property, within the contemplation of the Fifth Amendment, is premised on governmental actions entailing an actual invasion of private property rights. Thus, where plaintiff has failed to establish that Navy officials acted to invade his rights in the materials salvaged from his contracted demolition work at Guantanamo base or to interfere with his use or possession thereof by allegedly denying his request for permission to remove the materials, the fact that plaintiff was unable to remove his property to any place but Cuba because of the 1903 lease agreement for Guantanamo, and was unwilling to remove it to Cuba because of the events occurring there, so that the property was for all practical purposes confined on the base, does not make the Government, in its contractual capacity, responsible for these circumstances or liable for a taking within the contemplation of the Fifth Amendment.

Eminent Domain ⟸ 2(1)

**Court of Claims jurisdiction; tort claims asserted in petition.**

[4] If alleged pilferage of plaintiff's property was committed by alleged agents of the Government, and was used in the building of structures on Guantanamo base (facts which plaintiff has failed to prove), such acts would not in any event constitute a "taking" by the Government, but would rather constitute tortious acts beyond the jurisdiction of this court to consider.

Eminent Domain ⟸ 2(1)

*F. Trowbridge vom Baur*, attorney of record, for plaintiff. *vom Baur, Coburn, Simmons & Turtle*, of counsel.

*Marc J. Fink*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS, and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision of Trial Judge Louis Spector, filed October 21, 1975, pursuant to Rule 134(h), having been submitted on the briefs and oral argument of

counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision,* as hereinafter set forth, it hereby affirms and adopts said decision as the basis for its judgment in this case. It is, therefore, concluded that plaintiff is not entitled to recover and the petition is dismissed.

OPINION OF TRIAL JUDGE

SPECTOR, *Trial Judge:* When Fidel Castro came to power in Cuba in 1959, many Cuban nationals and others lost commercial and personal property located in Cuba as a result of the confiscatory acts of the Castro regime. Plaintiff in this case, Juan M. Huerta, a Cuban national until his American naturalization in 1974, was one of those who incurred property losses attributable to the policies of the Cuban Government. His position is unique, however, in that part of his property so lost was situated on territory controlled not by Fidel Castro but by the U.S. Navy at Guantanamo. He brings this action to recover almost $900,000 on the alternative grounds of breach of contract, and the uncompensated taking of property. The property, hereinafter described, has rested on the naval base since the early 1960's, and what is left of it remains there today.

Plaintiff, aided by his brother Guillermo Huerta, conducted a large and profitable demolition, salvage, and construction materials business in Santiago, Cuba, during the period 1956–63. Beginning in 1958, he from time to time performed demolition work for the Navy on its base at Guantanamo Bay, some 80 miles from Santiago. In the years 1960, 1961, and 1962, plaintiff was awarded and performed five demolition contracts on the base, taking as the principal consideration for his work the title to all materials, with certain exceptions not relevant here, which he carefully salvaged from the structures he demolished. It had been plaintiff's custom under previous contracts to remove the salvaged materials to his place of business in Santiago for eventual

*The opinion of DAVIS, Judge, dissenting in part, follows the opinion of the trial judge which has been adopted by the court.

Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed October 21, 1975, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

resale. There was a brisk market for those materials in Cuba. However, for reasons vigorously disputed by the parties, the materials salvaged from the above five contracts never left the base but remained on a storage site that the Navy made available for plaintiff in late 1960. Those materials, now valueless due to prolonged exposure to the elements and certain alleged thefts, are the subject matter of this case.

Plaintiff claims that the United States is responsible for the fact that he received no economic benefit from his salvaged materials because of the acts and omissions of certain Naval personnel on the base. He states three separate grounds for recovery. First he says the United States breached all five contracts when Navy officials in effect refused his requests for permission to take the materials into Cuba. They did this, he avers, by continually telling him over a 2-year period that removal to Cuba was not currently permissible, all the while assuring him that obstacles to removal would soon disappear. However, he says permission to remove was never granted, and this converted the Navy's words into ones of refusal.

Plaintiff's first theory of recovery is that the Navy's refusals constituted a breach by depriving him of the principal consideration for his contracts, by violating an implied covenant of cooperation, or by amounting to a cardinal change order. The latter premise is based on the parties' understanding in executing the contracts that plaintiff could and would take the salvaged materials into Cuba for resale.

The second ground asserted is that there was a taking of his property without compensation, by virtue of the same Navy refusals of his requests to remove it (hereinafter, "first taking claim"). Finally, plaintiff complains that his materials, while stored on the base, were physically appropriated by agents of the United States and used in the building of base structures. This, he urges, also constituted an uncompensated taking of his property ("second or pilferage taking claim").

The Government disclaims all responsibility for plaintiff's loss. It responds that plaintiff never requested permission to take his materials into Cuba; that he elected not to take the property there, for reasons hereinafter amplified,

and that there was no appropriation of the materials for a public use by agents of the United States.

The defendant further disavows liability by raising a series of independent defenses unrelated to the above-described issue on the merits. Its answer to the petition alleges that since plaintiff was a Cuban national, this court lacks jurisdiction to entertain his suit under the so-called Reciprocity Statute, 28 U.S.C. § 2502 (1970), unless American citizens also had the right to sue the Cuban Government in its courts. Next, says defendant, the defense of "sovereign act" relieves it of any liability in contract that may arise from the imposition of a trade embargo in 1962, as further described below. Finally, it raises for the first time (in its response to plaintiff's pretrial statement on liability) the defenses that the 6-year Statute of Limitations, 28 U.S.C. § 2501 (1970), had run before plaintiff filed his petition in this court on February 26, 1969, and further that the Government was discharged by releases executed by plaintiff on each of the five contracts. None of these independent defenses was raised by filing a motion for summary judgment.

As hereinafter indicated, this case has from the beginning been considered and tried on its facts, and on the "merits" issue earlier described. Resolution of that issue therefore represents the most efficient avenue for disposition of the case.

Trial was held on the breach and the two taking theories from March 26 to April 1, 1974. Earlier, the contracting officer had issued a final decision on August 9, 1967, denying plaintiff's request for an equitable adjustment under the five contracts. Plaintiff thereafter prosecuted an appeal to the Armed Services Board of Contract Appeals. The board denied the appeal on April 6, 1971, on the ground that relief was not available to plaintiff under the contract terms. On July 6, 1971, plaintiff filed a petition with this court amending his originally filed protective petition of February 26, 1969. The amended petition is the basis for the present suit for a breach and a taking. Plaintiff then moved for a trial de novo in this court. His motion was granted and not appealed. Defendant's later motion that the board's decision be deemed binding in the trial de novo was denied, and the denial upheld on appeal.

The testimony on the merits of the case is voluminous and in direct conflict, although certain details providing background for the parties' various actions are not disputed, and provide an important objective guide to resolution of conflicting evidence. The evidence is set forth in detail in the findings of fact, and only briefly summarized here.

The Government of Cuba, under Castro's leadership, embarked on a program of state ownership and direction of major, basic business enterprises in Cuba beginning in 1960. A large number of Cuban-owned businesses were "nationalized" or "intervened" immediately and this pattern was continued over a period of years until even small enterprises were subjected to seizure starting in 1964. During the same period relations between the United States and Cuba deteriorated rapidly. All American property in Cuba was expropriated in late 1960, following President Eisenhower's reduction of the Cuban sugar import quota. After expropriation, the Commerce Department issued a ban on exports from the United States to Cuba.

The first contract at issue was signed just before the expropriation of American property by Cuba, and the second contract shortly thereafter. The two nations severed diplomatic relations in January 1961, just as performance on the first two contracts neared completion. By April of 1961, the Bay of Pigs invasion had occurred, failing in its objective, and creating further hostility between the two countries. Soon thereafter the Cuban Government forbade the movement of all vehicular traffic through the northeast gate at Guantanamo. This was the only land route from the Guantanamo Base to Cuba. In May 1961, the Cuban Central Bank placed tighter controls on foreign exchange transactions involving American dollars and Cuban pesos.

After performance under the third contract was completed, and while work on the fourth was underway, President Kennedy, on February 3, 1962, issued Proclamation No. 3447, placing a total embargo on Cuban-American trade. This Proclamation recited that the earlier Commerce Department ban on exports to Cuba remained in effect. Plaintiff and base construction officials thereafter recognized the February 1962 Proclamation as a legal impediment to the move-

ment of plaintiff's property into Cuba from Guantanamo, and as the first such explicit barrier. The following month plaintiff signed the fifth and last contract. This was the only one containing a clause expressly permitting plaintiff to store his materials on the base.

On the breach of contract and "first taking" claim issues, the parties disagree as to whether plaintiff actually ever requested permission to take his materials from the base and into Cuba. This is the fundamental issue. There is a substantial body of evidence and a host of arguments addressed to that crucial issue of fact. Plaintiff and his brother, Guillermo, testified that they made such requests to officials of the Base Public Works Center to whom such removal requests were traditionally addressed. The latter deny ever receiving any such requests. Each side produced exhibits and additional testimony in support of its respective version of the facts.

Defendant's witnesses state, for example, the plaintiff did not make timely cash payment of sums owed to the defendant under the first two contracts, due to his shortage of American dollars. Since this was the only form of payment acceptable under the contracts, the Navy then reluctantly arranged for the purchase of part of plaintiff's salvaged materials to satisfy plaintiff's debts to defendant. The significance of this, argues defendant, is that plaintiff could not have made his first three removal requests, as he testified he did, until those contract debts were satisfied since the contracts, by their terms, forbade removal of salvaged materials from the base until payment by the contractor. Plaintiff responds that he did not experience a dollar shortage at all during this period, and that the purchase of part of his salvaged materials to satisfy his contract obligations was the Navy's idea, not his. The Navy wanted the materials, he avers, or wished another party to have them.

Plaintiff accuses the Navy of blocking removal of his materials for the purpose of denying aid to the Castro Government, a goal popularly supported by public opinion at Guantanamo, particularly among the refugee population. Public Works officials respond that they had no such motivation and knew of no base policy to this effect. On the contrary, they testify, plaintiff was worried that if he took

his materials into Cuba the Cuban Government would confiscate them, and he had so advised the Navy. Plaintiff denies that he had any fears of this sort nor that he made statements to that effect. Plaintiff further asserts that others on the base had heard him complain about Navy refusals to grant his removal requests and that one Sgt. (now Capt.) George Alvarez, USMC, told plaintiff that base officials could not let his salvaged materials enter Cuba due to the embarrassment that would result from aiding the Castro Government. Plaintiff's contacts with Alvarez, who was assigned to intelligence duty by the base commander, were to convey information to him about events in Cuba. The Huerta brothers made frequent trips back and forth in connection with their business.

Defendant replies that the testimony of plaintiff's witnesses to that effect, including that of Alvarez, is mere hearsay, and that in any event it is not probative of the conduct of Public Works officials in charge of these particular contracts. It is further argued that Alvarez' statement represented a personal opinion, as he admitted, and that it was merely an affirmation of the fact that the 1962 trade embargo had by then already been imposed, rendering all other discussion academic.

To plaintiff's claim that the northeast gate into Cuba was closed by the Navy in February 1961, defendant responds that one Vargas, another demolition contractor, had taken his salvaged materials into Cuba through that gate in late February or early March 1961. Plaintiff also suggests that he was losing faith in the Navy's assurances of eventual permission to remove salvaged material, and this explains why he required greater compensation for the fifth and last contract. Defendant counters that he was the sole bidder for the fifth contract, and that would explain the higher compensation paid.

There is in the record a Public Works' letter of March 1, 1963, acknowledging a removal request had been made by plaintiff. Defendant explains that plaintiff asked the Public Works Center to write such a letter as a ploy to keep certain Cuban officials at bay. They were pressuring plaintiff to bring his salvaged materials into Cuba, a step which plaintiff

did not wish to take. Defendant further questions why plaintiff never reduced his alleged removal requests to writing, and plaintiff explains that such requests had traditionally been oral.

The foregoing very lightly summarizes the conflicts in the testimony at trial. One thing is clear. Plaintiff's failure to take his salvaged materials into Cuba was followed by seizure of his entire Santiago business property by the Cuban government. He was reimbursed for only a fraction of its true value. Plaintiff and his brother thereafter became exiles.

Prior to exile, in August 1962, plaintiff had sought permission from the base to travel abroad to market his salvaged materials elsewhere, but he was refused permission on the ground that the 1903 Base Leasehold Agreement between Cuba and the United States prohibited use of the base as a commercial port by Cuban nationals. After he was exiled, however, he requested and received permission in mid-1963 to leave the base for the United States, and he attempted in at least one instance to locate buyers there for his salvaged materials. Public Works Center officials aided in this venture. Plaintiff returned to the base only once (from October 1963 to January 1964), and he has since lived in the United States. He has never managed either to sell or to remove the materials stored at Guantanamo.

Upon a review of the evidence as a whole, as detailed in the findings, it is concluded that plaintiff has failed to establish he ever made a request to the Public Works Center, or to anyone else in authority, for permission to remove his salvaged materials to Cuba. Instead, the evidence compels the conclusion that plaintiff elected to retain the materials at the storage site on Guantanamo, rather than ship his property into Castro Cuba, because that was the lesser of two evils during the period in question.

On the "second or pilferage taking claim," the parties are in equally serious dispute as to whether any persons removed plaintiff's materials from his stockpile without his approval, let alone whether any such persons who may have so removed materials did so as defendant's agents, or with authority from defendant. The use to which the allegedly pilfered materials was put, is also in dispute. Plaintiff contends through his

witnesses that military and other base personnel from time to time took quantities of materials from his stockpiles and used them in Government construction on the base. However, no witness for plaintiff could testify to an occasion when he saw base construction personnel actually remove material from the stockpile without plaintiff's permission.

Furthermore, the quantum of materials said to have been taken was not stated; the authority of the alleged pilferers was not established; and the base structures which allegedly benefited from the pilferage were not identified. Defendant did establish through the testimony of Public Works officials, moreover, that orders had been issued to all base personnel, civilian and military, involved in Government construction work at Guantanamo, to the effect that plaintiff's materials were private property and could be acquired only with plaintiff's authorization.

Taking all the evidence on this issue into account, it is further concluded that plaintiff has not established the removal or pilferage of his property by persons on the base, nor the identity of the alleged pilferers as agents of the defendant, nor the use of his property in Government structures, nor the authority for any such appropriation or use.

On the basis of the foregoing ultimate conclusions of fact, it follows that plaintiff is not entitled to recover on any of his three stated grounds. A breach would depend on requests for permission to remove, which were wrongfully refused. Those essential facts have not been established in this case.[1]

The second ground predicated on an uncompensated "taking" is also starved for want of the same essential facts, namely, persuasive proof of requests for permission to remove, followed by refusal of those requests. One can readily appreciate the plight of plaintiff, unable to remove his property to any place but Cuba because of the 1903 lease agreement for Guantanamo, and unwilling to remove it to Cuba because of the historical events which had overtaken that country. As a result, his property was virtually imprisoned on the base. But that is not to say that defendant, in its con-

[1] *See* and contrast *Miller* v. *United States*, 135 Ct. Cl. 1, 140 F. Supp. 789 (1956), where a purchaser of Government property was specifically advised by the Government that it would not be delivered to him.

tractual capacity, was responsible for these most unfortunate circumstances.[2]

The concept of a "taking" of property, within the contemplation of the fifth amendment, is premised on "governmental actions entail[ing] * * * an actual invasion of private property rights." Though there need be no official intention to acquire any property interest "interference with use or possession" of property is essential to a taking claim. *Eyherabide* v. *United States*, 170 Ct. Cl. 598, 601, 345 F. 2d 565, 567 (1965). Plaintiff has simply failed to establish that Navy officials acted to invade his rights in the salvaged materials, or to interfere with his use or possession thereof, by denying transit to Cuba, or otherwise.[3]

The "second or pilferage taking" claim relies on different facts. Plaintiff's witnesses referred to these alleged appropriations as thefts, stealing, and pilferage. But here again the evidence falls short. It has not been shown that materials were removed by persons acting without plaintiff's permission, that those persons were Government agents, or that the material so removed was incorporated in Government construction.[4]

If unlawful acts by Government personnel did in fact occur, they would not in any event constitute a "taking" by defendant, but rather tortious acts beyond the jurisdiction of this court to consider.[5]

---

[2] Plaintiff cites the 1960 Commerce Department export ban, the 1962 trade embargo, and the alleged assurances of Navy officials that these obstacles would eventually be lifted, as Government action that deprived him of his property. But those public acts were general acts of the sovereign and do not establish liability for breach, or for a taking in the circumstances of this case. *See*, for example, *Glasgow Associates* v. *United States*, 203 Ct. Cl. 532, 542–43, 495 F. 2d 765, 770–71 (1974).

[3] *See & cf. Lemmons* v. *United States*, 204 Ct. Cl. 404, 496 F. 2d 864 (1974); *Societe Cotonniere Du Tonkin* v. *United States*, 145 Ct. Cl. 426, 171 F. Supp. 951 (1959), *cert. denied*, 361 U.S. 965 (1960).

[4] *See Eyherabide*, text at note 3 *supra*. *See also Porter* v. *United States*, 204 Ct. Cl. 355, 496 F. 2d 583 (1974), *cert. denied*, 420 U.S. 1004 (1975); *Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 711, 468 F. 2d 922, 925 (1972); *Kelly* v. *United States*, 146 Ct. Cl. 416 (1959), *cert. denied*, 362 U.S. 975 (1960).

[5] *United States* v. *North Am. Transp. & Trading Co.*, 253 U.S. 330, 334 (1920); *Schillinger* v. *United States*, 155 U.S. 163, 168 (1894); *Anggelis* v. *United States*, 202 Ct. Cl. 1094, *cert. denied*, 414 U.S. 1065 (1973); *Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 663, 428 F. 2d 1241, 1249 (1970); 28 U.S.C. § 1491 (1970).

Accordingly, it is concluded that plaintiff is not entitled to recover on any of the three grounds offered. In view of that conclusion on the facts, and on the merits, it is unnecessary to reach the independent issues raised by defendant as earlier mentioned, nor the contentions of the parties addressed thereto, on sovereign act, jurisdiction, releases and limitations.

---

DAVIS, *Judge*, dissenting in part:

I join the majority of the panel in adopting most of the Trial Judge's opinion and findings but I dissent with respect to the so-called "pilferage taking claim." As to that demand I think that claimant has shown enough to warrant a judgment in his favor on liability, as well as a remand to the Trial Division to determine the amount of that taking and the quantum of recovery.

The main facts and factors leading me to the other position on this claim are these: (a) it is undisputed that by 1973 almost all of the lumber and material had disappeared, and it seems to me clear that by 1967 very serious losses had occurred; (b) the record makes it very unlikely, in my view, that the bulk of these losses was due to climatic conditions or to sales by the plaintiff; (c) on the contrary, the record persuades me that the great bulk of the materials were taken by personnel living or stationed on the base for use in connection with buildings or structures (on the base) owned by the United States and affixed to real property leased for a very long period to the United States (there were no private buildings and no private lands on the base); (d) there was sufficient, uncontradicted testimony that many of the materials removed from plaintiff's lots were taken by United States personnel in uniform and in government vehicles; (e) the Government necessarily received and retained the benefit of the removed materials because they were incorporated and used in government-owned buildings and structures; (f) whether or not the takings of this property were initially authorized, the Government obtained and retained the benefit of the removals and should therefore be required to pay just compensation (*see Oro Fino Consolidated Mines, Inc.* v. *United States*, 118 Ct. Cl. 18, 23, 92 F. Supp. 1016, 1019 (1950), *cert. denied*, 341 U.S. 948 (1951); *Forest of Dean*

Syllabus

*Iron Ore Co.* v. *United States*, 106 Ct. Cl. 250, 65 F. Supp. 585 (1946); *Silberman* v. *United States*, 71 F. Supp. 895, 896 (D. Mass. 1947); *Ivey* v. *United States*, 88 F. Supp. 6, 8–9 (E.D. Tenn. 1950)); and (g) in any event, the defendant's inadequate efforts to prevent pilferage by personnel over whom it had the widest control (*i.e.* all personnel on the base), especially since that pilferage redounded to the defendant's own ultimate benefit, lead me to conclude that the "takers" had sufficient implied authority (*cf. Eyherabide* v. *United States*, 170 Ct. Cl. 598, 606–607, 345 F. 2d 565, 570 (1965)).

This taking claim is not barred by limitations since, in my view, it did not mature until after June–July 1963 (*see* finding 79 and *United States* v. *Dickinson*, 331 U.S. 745 (1947)). The petition here was filed less than six years later in February 1969. As for the defense under 28 U.S.C. § 2502 (reciprocity), I would hold that provision inapplicable to suits by alien friends for just compensation for property taken by the United States within an area over which the United States has as much control as over Guantanamo Naval Base. *See Russian Volunteer Fleet* v. *United States*, 282 U.S. 481, 491–92 (1931).

CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

---

549 F. 2d 190

## TRISTATE DEVELOPERS, INC. v. THE UNITED STATES

[No. 439–72. Decided January 26, 1977]

ON THE PROOFS

**Taxes; employment tax; employee or independent contractor.**—Plaintiff, a home improvement contractor, a substantial part of whose business is the installation of new siding or roofing to the homes of its customers, seeks to recover Federal employment taxes which it paid for years 1968 and 1969 assessed by the Government

Syllabus

as due on the earnings of certain home siding and roofing "applicators" performing such work under contracts with plaintiff. On the basis of the whole of the particular facts, it is *held* that the applicators were independent contractors rather than employees of plaintiff during the periods involved, and accordingly plaintiff is entitled to recover. Judgment is entered for plaintiff with the amount of recovery to be determined under Rule 131(c). Defendant's counterclaim is dismissed.

**Taxes; employment tax; employee-independent contractor.**

[1] Whether a person is an employee or an independent contractor for employment tax purposes depends upon the whole of the particular facts in the application of the common law factors for determining the existence of employer-employee relationship, the right and degree of control exercised by the principal being a significant factor.

Internal Revenue ⟸ 1167.9

**Taxes; employment tax; employee-independent contractor.**

[2] A home improvement corporation (HIC) for withholding tax purposes was not an employer of siding and roofing applicators performing work under contracts with HIC where the applicators were skilled and experienced craftsmen possessing the ability, without supervision or direction, to perform the work required by HIC's work order specifications; they performed their work for the most part on their own time schedules, selected and paid their own help, and chose their own partners for the contract jobs; they owned and furnished at considerable expense their own tools, equipment and transportation vehicles without reimbursement by HIC; they were paid on a per job basis at rates negotiated with HIC, the rates differing among the applicators for the same work depending upon their prior record with HIC and HIC's needs for their services from time to time; they were free not only to accept or reject HIC's jobs but were free to accept jobs from HIC's competitors; they received no instructions from HIC concerning, nor did HIC exercise any right to control, the method or manner in which the work was to be performed other than the instructions contained in the work order specifications; if HIC was dissatisfied with the work of a particular applicator, HIC did not discharge him (with one exception) but simply would not offer him another work order; and HIC had the right to control only the result to be accomplished by the applicators. Based on a totality of the facts, the applicators were independent contractors.

Internal Revenue ⟸ 1167.9

*Joseph J. Lyman*, attorney of record, for plaintiff.

*Fenton P. Wilkinson*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser and Robert S. Watkins*, of counsel.

Before COWEN, *Chief Judge*, DAVIS, and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on defendant's exceptions to the recommended decision of Trial Judge Lloyd Fletcher, filed October 21, 1975, pursuant to Rule 134(h), having been submitted and considered on the briefs and oral argument of counsel.

Like the earlier "applicator" cases, this case is controlled by the whole of its particular facts. The trial judge properly points out the significant differences from *William C. McCombs Co.* v. *United States*, 193 Ct. Cl. 644, 436 F. 2d 979 (1971). The present case is more like *Rayhill* v. *United States*, 176 Ct. Cl. 1120, 364 F. 2d 347 (1966) and *Powers* v. *United States*, 191 Ct. Cl. 762, 424 F. 2d 593 (1970), and falls within the area marked out by those decisions; the differences from those cases which defendant cites are not significant in the light of the totality of the circumstances.

Since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby adopts the same as the basis for its judgment in this case. Therefore, it is concluded the plaintiff is entitled to recover and judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c) in accordance with this opinion. Defendant's counterclaim is dismissed.

OPINION OF TRIAL JUDGE

FLETCHER, *Trial Judge:* The issue in this case must bring to the court a resigned feeling of *déjà vu*. Once again, it is necessary to wrestle with the familiar common law distinction between an employee and an independent contractor, as the courts have done so many times before. Not that the legal principle is esoteric; far from it. In *Illinois Tri-Seal Products, Inc.* v. *United States*, 173 Ct. Cl. 499, 353 F. 2d 216 (1965), the court has succinctly put the distinction, as follows, at 173 Ct. Cl. 510, 353 F. 2d 223:

> * * * It is, of course, fundamental that under the common-law test, the relationship of employer and employee exists where the principal has the right to direct the manner and method in which the work shall be done, as well as the result to be accomplished, while an independent contractor relationship exists where the individual

> who performs work for another does so according to his own manner and method, free from direction or right of direction in matters relating to the performance of the work save as to the result.

For all employment tax purposes, the Internal Revenue Code and the Treasury Regulations promulgated thereunder have specifically adopted this common law test for ascertaining the existence of the employer-employee relationship, *Enochs* v. *Williams Packing Co.*, 370 U.S. 1, 3 (1962), and the regulations rightly conclude that:

> (3) Whether the relationship of employer and employee exists under the usual common law rules will in doubtful cases be determined upon an examination of the particular facts of each case. Treas. Reg. § 31.3121(d)–1.

Since the problem for the court, therefore, is basically factual, it is necessary to proceed with an elaboration of the facts adduced at the trial,[1] bearing in mind that the sole issue for decision is whether certain home siding and roofing "applicators" performing such work under contracts with plaintiff were its employees or were independent contractors.[2] If these several applicators were independent subcontractors for plaintiff (sometimes "Tristate"), then plaintiff is entitled to recover herein. On the other hand, if these persons were Tristate's employees, defendant is entitled to prevail on its counterclaim under the provisions of Sections 3101 *et seq.*, 3301 *et seq.*, and 3401 *et seq.* of the Internal Revenue Code of 1954. Upon the facts now to be described, I have concluded that the applicators who performed jobs for Tristate were not its employees but were independent contractors during the periods involved. Accordingly, judgment should be entered for plaintiff and the counterclaim dismissed.

The court is no stranger to the concept of "applicator" (sometimes also referred to as "installer" or "mechanic") as

---

[1] The detailed facts of the case are set forth in the findings of fact below. They will be summarized here only to the extent necessary to explain the basis for decision.

[2] Plaintiff has also utilized the services of other individuals whose status originally was, but no longer is, controverted. Its bookkeeper-secretary, telephone solicitors, and expediters have now been conceded by Tristate to be its employees. In turn, the Government no longer contends for employee status of plaintiff's commission-salesmen and stone applicators.

that term is used in the home improvement business and has dealt with it on no less than seven prior occasions. *Ralls, Inc.* v. *United States*, 200 Ct. Cl. 240, 470 F. 2d 579 (1972); *William C. McCombs Co.* v. *United States*, 193 Ct. Cl. 644, 436 F. 2d 979 (1971); *Powers* v. *United States*, 191 Ct. Cl. 762, 424 F. 2d 593 (1970); *Rayhill* v. *United States*, 176 Ct. Cl. 1120, 364 F. 2d 347 (1966); *Illinois Tri-Seal Prods. Inc.* v. *United States*, 173 Ct. Cl. 499, 353 F. 2d 216 (1965); *Edwards* v. *United States*, 144 Ct. Cl. 158, 168 F. Supp. 955 (1958); and *Ben Construction Corp.* v. *United States*, 160 Ct. Cl. 604, 312 F. 2d 781 (1963). Nor has judicial consideration of applicators' employment status been confined to the Court of Claims. *See*, for example, *Alsco Storm Windows, Inc.* v. *United States*, 311 F. 2d 341 (9th Cir., 1962); *Ben* v. *United States*, 139 F. Supp. 883, *aff'd.* 241 F. 2d 127 (2d Cir., 1957); *Hoosier Home Improvement Co.* v. *United States*, 350 F. 2d 640 (7th Cir., 1965); *Consolidated Housecraft, Inc.* v. *United States*, 170 F. Supp. 842 (E.D., N.Y., 1959); *Jagolinzer* v. *United States*, 150 F. Supp. 489 (D.R.I., 1957); *Security Roofing and Const. Co.* v. *United States*, 163 F. Supp. 794 (D. Mass., 1958); *Fleeman* v. *United States*, 175 F. Supp. 336 (N. D. Ohio, 1959); *Zipley* v. *United States*, 156 F. Supp. 141 (E.D., Pa., 1957); and *Drake* v. *United States*, 75-1 USTC ¶9475 (N. D. Tex., 1975). Despite generally similar fact patterns, there has not been unanimity of result in these many cases.[3] They have been referred to, however, because in *McCombs*, *supra*, the court has observed that:

> * * * We do not subscribe to the idea that these cases do not bear on one another because they involve purely factual issues. Of necessity, the selection or rejection of underlying facts for use in arriving at ultimate conclusions of fact, must involve criteria which have precedential value and in effect are conclusions of law. 193 Ct. Cl. at 652-53, 436 F. 2d at 983.

Following a factual pattern generally similar to all these cases, the record here shows that Tristate is a home improvement contractor, a substantial part of whose business is the installation of new siding or roofing to the homes of its customers. During the periods at issue, this business was con-

[3] Although on a "nose-count" approach, most of the decisions arrive at a conclusion of independent contractor status for applicators.

ducted under the supervision of Tristate's general manager, Ben Abramson, who utilized the services of commissioned salesmen to obtain contracts from customers and applicators to do the labor (and sometimes furnish the materials) necessary to the performance of those contracts. He acquired the services of these applicators in several ways. Their names were sometimes obtained by plaintiff from wholesale materials supply houses where applicators customarily made known their availability to the trade generally. From previous experience with them plaintiff also kept a list of names of several qualified applicators whom it would call when needed. Others came to plaintiff's office by word of mouth from other applicators who had worked for plaintiff. Also, plaintiff inserted advertisements in the classified sections of newspapers for applicators, stating: "Wanted experienced siding applicators. Steady work. Good pay." Also, a few applicators advertised in the "yellow pages" of the telephone directory.

As customer contracts were obtained, the specifications therein were transferred to a work order which authorized not only the work to be done and the materials to be used but also the price to be paid any applicator who accepted the work order. Occasionally, starting and completion dates might also be stated, but generally the timing of work performance was left to the applicator subject to overall concern for customer satisfaction.

There was no competitive bidding, and any applicator deemed by plaintiff to be sufficiently experienced was free to accept any particular work order.[4] Some amount of bargaining as to price for the work took place, particularly where the job was unusual or fairly complex. Tristate's general position was that it should have to pay no more than prevailing area rates and it maintained a price list reflecting them which list price generally prevailed. However, in negotiating prices, Abramson took a more flexible attitude when applicators were in short supply or when, because of prior experience, he wanted the services of a particular applicator who had done good work for plaintiff in the past. The end result of this

[4] It was also understood that interested applicators were free to reject any proffered work order, and although such refusals were rare, they did not prejudice the rejecting applicator from being offered subsequent work orders.

procedure was that some applicators received one price and others received a different price for the same type of work.

The applicators were free to accept work orders of a similar kind offered by plaintiff's competitors and they would do so except in the case of a few applicators who preferred to work exclusively for Tristate. All applicators, in addition to experience requirements, had to furnish all necessary tools and equipment for the performance of the job, and each had his own truck or other form of transportation which was maintained without reimbursement or other payment by Tristate.[5] Some occasionally furnished the necessary materials but most of the time the materials were supplied and delivered to the job by Tristate. Some of the applicators were independent licensed contractors. They employed and paid their own helpers. Final payment by Tristate to an applicator for a particular job was made only upon completion of the job and the furnishing by the applicator of a completion certificate signed by the home owner. Tristate, however, would make various advance payments to applicators generally on Friday for work accomplished during the week.

Tristate did not actively supervise the applicators but depended upon their experience to satisfy the customer and comply with the specifications of the work order.[6] While Tristate had no foremen or supervisors, as those terms are generally understood, it did on several occasions employ as many as two persons known as "expediters" who would visit jobs in progress from time to time, the frequency of their visits depending upon the nature and number of any customer complaints and the company's prior experience with a particular applicator. As the name suggests, their job essentially was to see to it that satisfactory progress was being made by the applicators in completing their respective jobs. They also conveyed customer complaints to the applicators, and on their own initiative would sometimes criticize work which they considered to have been poorly done. They also collected money from customers.

[5] Tristate owned no trucks or tools other than (for a short period) a brake for forming aluminum which a few applicators used occasionally.

[6] Any faulty work had to be corrected by the applicator to the customer's satisfaction without further compensation.

Plaintiff owned signs which advertised its business with the slogan "A New Home at an Old Address by Tri-State Developers". These signs were placed at some but not all jobsites. Plaintiff asked the applicators to post these signs, and sometimes they did. At other times, the salesmen would post the signs on the customer's property. For a period of about six weeks, one applicator and his helper wore uniforms with plaintiff's name on them. This shortlived effort at advertising was suggested by the applicator but was aborted due to cleaning and other difficulties. The applicators' trucks carried no sign or other insignia identifying them in any way with Tristate Developers, Inc.

Mechanics sometimes worked for plaintiff in the capacity of ordinary manual laborers. On rainy days and during slack periods some would work at an hourly rate of pay in plaintiff's warehouse unloading materials from delivery trucks or delivering materials to jobsites. One mechanic would sometimes repair the work of another mechanic when a service call was necessary, and a charge would be made for such service call by the mechanic making the repair. Plaintiff tried to charge this cost back to the original mechanic if possible.

A few mechanics represented themselves to the customer as either an employee of plaintiff or as the "foreman" of the job. One mechanic, who was obviously hostile to plaintiff, testified that he was told by plaintiff not to tell customers that he was a subcontractor. He expressed the opinion that he was plaintiff's employee but freely admitted that he frequently left a job at mid-day and spent the afternoon drinking in a bar because he didn't think such absence from the job "was any of the company's concern". By way of contrast to these few instances, the record in this case demonstrates that the reliable and experienced applicators who performed jobs for plaintiff felt that they were in business for themselves.

This summary of Tristate's relationship to its applicators, expanded at length in the findings below, discloses a general fact pattern common to all cases in which applicators have been held to have independent contractor status. *See*, for example, *Rayhill* v. *United States*, *supra; Powers* v. *United*

*States*, *supra;* and *Ralls, Inc.* v. *United States*, *supra.* It would seem, therefore, that a like result is demanded here.

Defendant, however, contends vigorously that the present case is completely controlled by *William C. McCombs* v. *United States*, *supra*, in which the court held that, on its particular facts, the case had passed the outer limits established by *Rayhill* and like cases to such an extent as to require a finding of employer-employee status. But this effort to equate the facts in *McCombs* with those in the present case fails wholly to discern the significant differences between the two cases.

Probably the most salient of the numerous differences is the court's finding in *McCombs* that the home improvement contractor there had employed salaried supervisors who would visit the jobsites "to insure workmanlike performance and, if necessary, *to instruct* an applicator *in certain techniques and procedures*, such as overlapping aluminum channels, caulking of seams, spacing of nails, etc." 193 Ct. Cl. 654, finding 6. [Emphasis supplied.] Concerning this finding the court said:

> * * * Implicit in this finding is the desire of the plaintiff to control not only the result but also the manner of achieving it. The type of instruction given by the supervisors seems rather fundamental to the whole process, and shows that plaintiff, although preferring experienced applicators, when available, was also training people who had no previous experience in this line of work. Several witnesses indicated they had done no applicating work before coming to McCombs. These witnesses also indicated they had to obtain their tools from McCombs with cost being deducted from their subsequent pay. One who must learn his trade and acquire his tools from the person employing his services can hardly be classified as an independent contractor. 193 Ct. Cl. 650.

No comparable situation existed in the present case. In contrast, just as in *Rayhill*, Tristate offered work orders only to experienced applicators who were deemed capable of performing the work even though, as might be expected in any subcontractor relationship, some applicators were more skilled and competent than others. Unlike their own helper-employees, these men needed no instruction or supervision in the performance of their work orders, and in fact knew much

more about the techniques involved than Abramson himself who never visited a job-site. To him the important consideration was the applicator's experience and the absence of customer complaints. Even after he had hired expediters, it was understood that their basic functions were to remedy problems of uncollected bills and complaints over poor workmanship, to assess problems (such as undetected rot) which arose during a job, to arrange bank financing for customers, to verify the amount of materials needed, and generally to keep the jobs moving to an expeditious conclusion. Although they sometimes suggested to a mechanic that he should caulk more around windows or straighten a bent aluminum panel, their function was not to *instruct* an applicator in certain techniques and procedures, such as overlapping aluminum channels, caulking of seams, spacing of nails, etc., as was done by the McCombs Co. supervisors. The expediters did not teach Tristate's mechanics their trade. Their work served to improve customer relations, to avert probable customer complaints about things which their prior experience as applicators gave them reason to anticipate, and in general to contribute to efficient functioning of the company through obviating time-consuming and expensive corrections. Thus, their function more closely resembles that of the contractor's representatives in *Powers* than that of the supervisors in *McCombs*. *See* finding 19 in *Powers* v. *United States*, *supra*, at 191 Ct. Cl. 783. Further, Tristate's applicators furnished their own tools.

Another fact which moved the *McCombs*' applicators from the more typical subcontractor pattern into employee status was that the contractor there could fire an applicator for cause before completion of the job. This right existed and was exercised in *Powers*, too, but the court's opinion observed that "plaintiff's actions toward this applicator [who got drunk, suffered an injury, and failed to show up for work] were not those of an employer discharging an employee. Rather, they were a manifestation of the right of a general contractor to declare that his subcontract had been breached by the subcontractor." *Powers* v. *United States*, *supra*, at 191 Ct. Cl. 771. As in *Powers*, Tristate had discharged one applicator during a job without permitting him to finish, but

this incident also occurred in the atmosphere of a contractor's right to terminate his subcontractor for unsatisfactory performance of the contract. Usually Tristate permitted applicators to complete a job and, if dissatisfied with his work, simply did not offer him further work orders in the future.

Tristate's situation is further dissimilar from the plaintiff's in the *McCombs* case because of the absence of a mutual intent to establish or perpetuate an employee relationship. Tristate did wish to compile a list of experienced "regulars" on whom it could rely for dependable work, but even these "regulars" felt no obligation to make themselves constantly available to Tristate, and some freely accepted applicator jobs elsewhere.

Other crucial dissimilarities show the inapplicability of *McCombs* to the present case. In the area of representation to the public at large, for example, *McCombs* furnished three uniforms to its applicators "with McCombs Company advertising emblazoned thereon" and paid one-half the laundering cost. In addition, *McCombs* arranged to display advertising on the trucks of several applicators. 193 Ct. Cl. 651. No such efforts were made by Tristate to create a public impression that the applicators were its employees. To the contrary, it restricted this type of advertising to a simple display of its signs at the jobsite,[7] which was characteristic of the prior cases.

Further, *McCombs* paid part of the premiums for those applicators who participated in the company's group health and group life insurance programs and, in some instances, paid applicators lump sum bonuses as vacation pay. All these are clearly indicative of employer-employee status, but Tristate did none of these things. It did carry public liability and property damage insurance to protect itself against claims for damages and injuries caused by the applicators, but this type of insurance coverage in no way negates a contractor-subcontractor relationship. *See Rayhill*, *supra*, 176 Ct. Cl. at 1127, 364 F. 2d at 352.

[7] With one exception. At the suggestion of one of its applicators, he and his helper obtained uniforms at their own cost with Tristate's name printed thereon. After several weeks, the practice was abandoned.

In contrast to the factual situation in *McCombs*, it is also important to observe that the Tristate applicators, once they received a work order, were free to perform the work with partners or helpers of their own choosing. Tristate had no control, and did not attempt to exercise control, over an applicator's selection of such co-workers,[8] and this clearly indicates lack of control over the methods and details of performing the work. Tristate issued its payment checks only to the primary applicator and never to one of his helpers, although on rare occasions Tristate might issue checks to each applicator when working in partnership.

From a consideration of all these factors, one finally returns to the ultimate question of "right to control" which must always govern the outcome of these cases involving the distinction between an "employee" and an "independent contractor". Many years ago, Judge Learned Hand described the question in his typically pungent way as follows:

> * * * The test lies in the degree to which the principal may intervene to control the details of the agent's performance; and that in the end is all that can be said, though the regulation redundantly elaborated it. In the case at bar the plaintiff did intervene to some degree; but so does a general building contractor intervene in the work of his subcontractors. He decides how the different parts of the work must be timed, and how they shall be fitted together; if he finds it desirable to cut out this or that from the specifications, he does so. Some such supervision is inherent in any joint undertaking, and does not make the contributing contractors employees. *Radio City Music Hall Corp.* v. *United States*, 135 F. 2d 715, 717–18 (2d Cir., 1943).

Those graceful observations might well have been made with respect to the factual pattern of the present case.

Upon careful consideration of the entire record and its significant dissimilarities from the *McCombs* record, it is concluded that while plaintiff retained the right at all times to control the result of the work contracted for, and on which

[8] At times, Abramson expressed dissatisfaction with a particular helper's appearance, language, or work habits which might be offensive to Tristate's customers, but he did not consider that he had the power to fire such helper. He could withhold further work orders from the applicator involved.

applicators were used, plaintiff did not exercise direction and control over the manner and method of the applicators' work performance, nor did it retain the right to do so. Accordingly, under the authority of the seven applicator cases previously decided by the court and cited above, plaintiff is entitled to recover and defendant's counterclaim must be dismissed. From the figures contained in finding 32 below, it seems apparent that the total amount of plaintiff's recovery should be $2,898.60, plus interest thereon as provided by law. However, in the absence of an agreement by the parties to that effect, it seems appropriate to reserve a final determination of the exact amount of recovery for further proceedings under Rule 131(c).

## FINDINGS OF FACT

**1.** Plaintiff, Tristate Developers, Inc. (Tristate) is a Maryland corporation with its principal office in Hagerstown, Maryland, from which it conducted a home repair and remodeling business during the taxable years 1968 through 1971. Plaintiff's business facilities consisted initially of two rooms of office space and some warehouse space in Hagerstown. During the years in issue, plaintiff remodeled the exteriors of existing residential homes of frame construction. It did not remodel commercial buildings or perform any interior work.

**2.** Essentially, plaintiff's business consisted of the sale and application of structural materials to the homes of residential property owners, including roofing, aluminum and vinyl siding, rain carrier equipment such as gutters, downspouts, and the like, asphalt roofing shingles, storm windows and doors, aluminum soffit and facia covering, and precast stone facing. Plaintiff's business also necessarily involved the performance of incidental carpentry work. All work was done under written contracts with customers.

**3.** Plaintiff's aforesaid business was conducted under the supervision of Ben Abramson, who, as general manager, had overall responsibility for all of plaintiff's operations during the periods involved herein. At the present time, he is plaintiff's president and sole stockholder. His managerial duties were generally to supervise plaintiff's activities and par-

ticularly to secure sales for the company through newspaper advertisements and telephone solicitations. His home office staff consisted of several telephone solicitors, who were salaried employees, and a bookkeeper-secretary, who was paid on an hourly basis.

4. Tristate also utilized the services of salesmen who were paid on a commission basis to solicit customers whose homes needed repair or renovation and "expediters" who were paid on a salary basis. The bookkeeper-secretary, the telephone solicitors, and the expediters have been conceded by plaintiff to be common law "employees". Defendant, in turn, has conceded that the salesmen were not such "employees" of plaintiff. Defendant has also conceded that those persons who were engaged by plaintiff to apply precast stone facing materials to its customers' homes were not plaintiff's common law "employees". These mutual concessions leave at issue the employment status only of those persons engaged by plaintiff as "applicators" to install on its customer's homes such items as roofing, siding, windows, doors, shutters, gutters, downspouts, and the like. Hereafter, the latter persons are sometimes referred to as "mechanics," or simply as "applicators".

5. The applicators performed work for plaintiff pursuant to work orders offered them by plaintiff on an individual basis. These work orders were prepared by Abramson from the information contained in customer contracts obtained by plaintiff's salesmen and approved by plaintiff. Those contracts were on printed forms supplied by plaintiff to its salesmen. They contained the date, name, and telephone number of the customer, a description of the materials to be applied, the nature of the labor to be performed, the total price for the job, credit and financing information where applicable, a provision for rejection by the plaintiff if credit were disapproved, and usually a specific provision that the contract or work could be assigned to a subcontractor.

The work orders prepared by Abramson and furnished to the applicators [1] typically contained similar information such

[1] On some occasions Abramson might simply outline a work order in a telephone conversation with an experienced applicator in lieu of furnishing him a written work order.

as the date, name, address, and telephone number of the customer, the salesman's name, a general description of the work to be done, the kind and quantity of materials to be applied, and occasionally starting and completion dates, and extra work to be done, e.g., "paint gable ends—remove window casing—cover bannister to top—cut with coil over top of front porch to stay with contour of existing porch—furr out in rear, etc." Where deemed necessary, directions to the jobsite were given. Many contained no remarks at all, and, other than an occasional reminder that customer satisfaction was required as to both labor and materials, no directions were given regarding the method or manner of accomplishing the work. In general, the more complex the job, the more detailed the specifications in the work order.

6. Plaintiff acquired the services of these applicators in several ways. Their names were sometimes obtained by plaintiff from wholesale materials supply houses where applicators customarily made known their availability to the trade generally. From previous experience with them plaintiff also kept a list of names of several qualified applicators whom it would call when needed. Others came to plaintiff's office by word of mouth from other applicators who had worked for plaintiff. Also, plaintiff inserted advertisements in the classified sections of newspapers for applicators, stating: "Wanted experienced siding applicators. Steady work. Good pay." Also, a few applicators advertised in the "yellow pages" of the telephone directory, although it would be very rare for an applicator to maintain a business phone as such, distribute business cards, or place business advertisements in a newspaper.

7. As would be expected, in deciding whether to offer a work order to an applicator with whom plaintiff had no prior contact, consideration was given to his previous experience with others in siding and roofing installation. In general, plaintiff desired a new applicator to be experienced in the trade, although no rule of thumb was used as to number of years of required experience, and no effort was made to investigate his reputation with other home improvement contractors for whom he may have worked in the past. Experienced applicators were sometimes difficult to find, particu-

larly during good-weather months,[2] and when plaintiff's backlog of work was relatively high, Abramson would tend to engage the services of applicators with less experience and expertise than he ordinarily would require.

**8.** In addition to satisfactory experience, an applicator was also required to possess his own equipment for accomplishing the work. This equipment included hand tools, ladders, ladder-jacks, walking planks, brakes (used to bend material), metal cutters, electric table saws, hand saws, and a truck or other vehicle for transporting material and equipment. With most applicators, this investment in tools and equipment, exclusive of a truck or other vehicle, amounted to about $3,000 on an average. Applicators paid their own maintenance expenses and insurance premiums on their trucks, without reimbursement from plaintiff, except that in the case of a particularly remote job they would receive some reimbursement frequently in the form of an increased price for the job.

Plaintiff owned a brake for a short period of time, and a few applicators used it on occasion. Other than the brake, plaintiff owned no truck, tools, or any of the necessary equipment described above. Infrequently, an applicator might purchase a needed tool on plaintiff's credit and thereafter keep the tool. He would pay plaintiff for the cost thereof, usually by a deduction from amounts due him by plaintiff. In the case of jobs which required some unusual piece of equipment, such as a very long ladder, the applicators were told that they could rent such item for which they would be reimbursed by plaintiff.

**9.** Upon being tendered a work order, an applicator had to decide whether he would take the job or not. There was no "competitive bidding" between interested applicators as that system is generally known in the construction industry, but some bargaining did take place. Abramson would inquire of the applicator as to his charge per 100 square feet of material applied, and the cost of any extra work to be performed. The applicator would state the amount of compensation he wanted which might be based upon his usual hourly charge

[2] As in the case of most outdoor construction activity, home improvement work tends to be seasonal in nature, the winter months being relatively slack.

or, more often, upon his charge for the items in a job (*e.g.*, square footage of siding, number of gutters, downspouts, shutters, and the like). If a job appeared particularly difficult, such as a 3-story house, or was fairly distant from Hagerstown, the mechanic usually would ask more.

Thereupon, Abramson would bargain with the mechanics over the amount of compensation. As a bargaining tool, he maintained a standard price list which he used as a guide in arriving at a price with the applicators. The prices on this list had been compiled from prevailing rates in the local trade and from typical prices previously paid to plaintiff's applicators. In bargaining with an applicator, Abramson always endeavored to bring the applicator's asking price down to the price on plaintiff's standard price list. Usually he was successful, particularly in bargaining with a new applicator who had never done work for plaintiff before. He took a more flexible attitude, however, when applicators were in short supply or when, because of prior experience, he wanted the services of a particular applicator who had done good work for plaintiff in the past.[3] The end result of this procedure was that some applicators received one price and others received a different price for the same type of work.

**10.** All jobs were tendered by plaintiff on a job-by-job basis, and each job was a separate undertaking. There was no agreement that plaintiff would give an applicator any predetermined number of jobs over a period of time. Abramson did attempt to keep the applicators (particularly the more skillful ones) busy with jobs and in this sense tried to assure them of steady work. However, plaintiff and the applicators felt no legal obligation to each other regarding employment beyond the particular job being performed. Neither does there appear to have been any sense of loyalty existing between plaintiff and the applicators.[4]

**11.** An applicator was free either to accept or to reject a work order offered him by plaintiff. Most of the applicators,

[3] As stated by one applicator-witness, "Eventually I got my [price]." (Tr. 870).

[4] One applicator liked to work for plaintiff because its checks did not "bounce". Another showed hostility towards plaintiff, a subjective feeling which was probably attributable to a personality clash with one of plaintiff's expediters.

however, regularly accepted jobs offered them. Those applicators who at one time or another refused a job later received other opportunities to work if jobs were available, and hence did not feel that rejecting any particular job would prejudice them with plaintiff. Rejected work orders were tendered to other applicators. When comparatively difficult jobs were involved, plaintiff tended to offer them to its more competent applicators, and usually they accepted such work orders.

**12.** Upon receiving a work order but before beginning work, a mechanic would visit the jobsite, inspect the house, talk to the owner, and verify the salesman's measurement figures as to materials and amount of work necessary. In the event of a discrepancy, it was necessary to confer with either the salesman or the expediter and arrive at the correct measurement.

**13.** Once an applicator undertook to perform a job for the agreed price, he was expected to start work as soon as practicable, usually on the following day. Occasionally, a starting date was specified. Many times a mechanic did not appear on a job which he had agreed to perform. On these occasions, plaintiff would simply engage another mechanic.

It was not customary to specify a fixed date for completion of a job. However, Abramson kept in touch with job progress by calling the mechanic at the jobsite, and if the job was progressing slowly, or if he had received a complaint from a customer, Abramson would ask the mechanic to spend more time on the job and expedite its completion. In general, however, the applicators ran their own time schedule and worked such hours as they chose. They took time off during jobs and between jobs without consulting Abramson in any way. They also set the work schedule for their crews, or helpers, without interference from plaintiff.

Plaintiff did impose certain rules, posted on its warehouse door, concerning swearing and drinking on the job. Rules regarding penalties for stealing from the warehouse were also posted. One mechanic, who breached the rule on drinking, was threatened by Abramson with the possibility that he would receive no more work orders if his drinking continued. Mechanics were expected to clean up the jobsite at the conclusion of each work day.

**14.** Plaintiff usually furnished the major materials for a job during the period involved. Prior thereto, the applicators bought their own materials and did their work on the basis of supplying both labor and materials. However, plaintiff preferred to supply the materials itself, and this became the customary, although not exclusive, practice. Where the applicator furnished both labor and material, his charge for applying siding might range from $50 to $60 per square, whereas when plaintiff furnished the siding materials, the labor charge by the applicator might range from $18 to $35 per square. Whatever basis was used, the applicator's charges were set forth on a "labor break-down" sheet composed either by the applicator himself or by Abramson from information furnished him by the applicator. In cases where plaintiff furnished the materials, they were shown as sold to the applicator who in turn would show the cost thereof in his bill to plaintiff. Hence, if he used less materials than those purchased, the excess unused materials belonged to the applicator.

**15.** Materials supplied by plaintiff might arrive at the jobsite in one of several ways but were expected to be on site by the time the applicator was ready to begin work. First, the wholesale supplier from whom plaintiff itself purchased the materials might deliver them. Second, a private trucker with whom plaintiff had contracted might deliver it. Third, plaintiff might hire a mechanic for the sole purpose of delivering materials to a job on which he was not working or might pay the mechanic who had the job an additional sum over the contract price for hauling materials to the job. Plaintiff did not own a truck in which material deliveries were customarily made.

**16.** Adequate performance of an applicator's job requires skills and know-how comparable to those possessed by a carpenter. All the applicators involved in this case possessed such skills in varying degrees. They were sufficiently knowledgeable to perform the shorthand type specifications used in the typical work order without instructions or other help from plaintiff, and this record shows that, except for a few unusual jobs where the applicator sought advice, the plain-

tiff furnished no directions regarding the method or manner of performance.

Hence, plaintiff employed no full-time job foreman, as that term is generally understood. At intervals, however, it did employ as many as two persons with prior experience in the trade who were known as "expediters". Essentially, their job (as the name suggests) was to see to it that satisfactory progress was being made by the applicators in completing their respective jobs. They also conveyed customer complaints to the applicators, and on their own initiative would sometimes criticize work which they considered to have been poorly done. They also collected money from customers.

For these purposes, the expediters would visit jobs in progress from time to time. Where an able and experienced applicator was performing the job, such visits would be infrequent. They would be more frequent to jobs where the applicator was not well-known to plaintiff or where the customer complaints were numerous. It was also customary for the salesman who had originally sold the job to visit the site while work was in progress. The general manager, Abramson, never visited the jobsites. He considered that payment by a customer implied satisfaction with the applicator's work. He could recall only one occasion when an applicator was discharged from a job for unsatisfactory work and immediately replaced by another mechanic. Usually, even an unsatisfactory mechanic was allowed to finish a job but was thereafter not offered any others.

**17.** When previously undetected rot or some other hidden defect was discovered during performance, the mechanic would telephone Abramson, advise him of the problem, and inquire as to what plaintiff wanted to do. Oftentimes the mechanic would state that he would have to make an extra charge on account of the defect, whereupon he and Abramson, or the expediter, would bargain over the amount of the additional cost.

Other circumstances which caused an applicator to call Abramson were shortages of materials and requests from the customer for additional work not listed on the work order. In each situation, the applicator sought Abramson's prior authorization. Abramson does not recall that any mechanic

ever called the plaintiff's office to say that he was having trouble in performing the work and needed help.

18. Occasionally a mechanic contracted directly with a customer to do extra work not encompassed by the work order, and in such instances the customer would pay the mechanic directly without involving the plaintiff. Except for very minor jobs, Abramson did not approve of this practice. He told the mechanics that they should always contact plaintiff when additional work of any significance was requested and should never contract directly with a customer before consulting him.

With respect to potential new jobs, Abramson asked mechanics to refer any "leads" to him and not to pirate the jobs for themselves. Some mechanics would always refer a lead, but others sometimes followed them up for their own account. On one occasion, Abramson threatened to withhold future work orders from a mechanic for his failure to refer a lead. The mechanic agreed to refer any future leads and even removed his name from his truck, but he did continue to accept work, when available, from plaintiff's competitors.

19. The plaintiff sometimes asked mechanics to "spike" another job during their course of work on a job. ("Spike" is trade jargon for affixing a few materials to a customer's house in furtherance of a contract in an effort to deter possible cancellation of the contract by the customer.) If the mechanic did not like the job to be "spiked," he would decline plaintiff's request. Usually, however, mechanics would "spike" when requested and most of the time would be offered the work order for completion of the job.

20. Mechanics frequently worked with the aid of "helpers," who formed the mechanic's crew. Plaintiff kept a list of helpers in the event a mechanic wanted to hire one. A mechanic could also "pick up" a helper around town, in which event it was doubtful that plaintiff would even know about the hiring. Friends would sometimes recommend a helper to a mechanic. Wages of helpers were paid by the mechanic for whom they worked, and plaintiff had nothing to do with such payments.

Plaintiff had no requirements as to the hiring or firing of helpers by its mechanics although at times plaintiff's man-

ager expressed dissatisfaction with a particular helper's appearance, language, or work habits. Since the helper was not employed by plaintiff, Abramson could not order the mechanic to fire the helper in such instances but would merely suggest that the mechanic "straighten him out" so that plaintiff's customers would not be annoyed. The mechanic, of course, would appreciate that his failure to correct such a situation might well result in a cessation of work orders from plaintiff.

**21.** Mechanics that worked for plaintiff also performed similar work for plaintiff's competitors. Abramson was aware of this and he did not approve of it. He told some mechanics not to take further work from competitors and threatened to give them no more work orders if they continued. For the most part, these mechanics complied with plaintiff's wishes, but others continued to obtain work wherever they could find it, and it was not uncommon for Abramson to call an applicator only to find that he was working elsewhere and unavailable to plaintiff for several weeks. This situation, however, did not deter Abramson from offering a work order to such applicator at a later time.

**22.** Plaintiff owned signs which advertised its business with the slogan "A New Home at an Old Address by Tri-State Developers". These signs were placed at some but not all jobsites. Plaintiff asked the applicators to post these signs, and sometimes they did. At other times, the salesmen would post the signs on the customer's property.

**23.** Mechanics sometimes worked for plaintiff in the capacity of ordinary manual laborers. On rainy days and during slack periods some would work at an hourly rate of pay in plaintiff's warehouse unloading materials from delivery trucks or delivering materials to jobsites.

One mechanic would sometimes repair the work of another mechanic when a service call was necessary, and a charge would be made for such service call by the mechanic making the repair. Plaintiff tried to charge this cost back to the original mechanic if possible.

If a mechanic damaged a customer's property in the course of his work, plaintiff would pay for the necessary repairs to correct the damage. Also, if materials at the jobsite were

damaged or stolen, plaintiff would replace them without charge to the applicator or customer.

For a period of about six weeks, one applicator and his helper wore uniforms with plaintiff's name on them. This short-lived effort at advertising was suggested by the applicator but was aborted due to cleaning and other difficulties.

**24.** A few mechanics represented themselves to the customer as either an employee of plaintiff or as the "foreman" of the job. One mechanic, who was obviously hostile to plaintiff, testified that he was told by plaintiff not to tell customers that he was a subcontractor. He expressed the opinion that he was plaintiff's employee but freely admitted that he frequently left a job at midday and spent the afternoon drinking in a bar because he didn't think such absence from the job "was any of the company's concern." By way of contrast to these few instances, the record in this case demonstrates that the reliable and experienced applicators who performed jobs for plaintiff felt that they were in business for themselves.

**25.** No mechanic ever asked plaintiff to withhold any type of federal or state taxes from his compensation, and plaintiff did not withhold any. From his experience with them, Abramson doubted if the mechanics would ever agree to the withholding of any tax. While the record is not entirely satisfactory on the matter, acceptable inference may be made that most of the applicators paid no self-employment taxes on their respective incomes, nor did they withhold employment taxes from the wages paid by them to their own employees, who are referred to above as "helpers".

**26.** The final completion of a job was signified to plaintiff by the applicator's presentation to it of a "completion certificate" signed by the customer. In this connection it was understood that a mechanic was required to rectify any work about which a customer complained before he would be paid in full, and there was no extra compensation for such corrective work. All mechanics understood the importance of obtaining the completion certificate and knew they could expect final payment for the job upon presenting the certificate to Abramson irrespective of whether or not plaintiff had received payment from its customer.

The actual computation of final payment involved a "labor breakdown sheet", whether the mechanics worked for plaintiff on a labor-and-materials basis or a labor-only basis. These breakdown sheets were usually prepared by Abramson in plaintiff's office although sometimes they were filled out and presented to Abramson by the applicator. In the latter case, disputes might arise over the rates charged by the applicator especially where the applicator felt entitled to increased compensation because of unexpected difficulties encountered on the job. Abramson usually won these arguments.

**27.** As stated, each job was paid for by plaintiff in full upon completion and presentation of a certificate signed by the owner. Sometimes partial payment, as an advance, would be made to an applicator upon his request before the job was actually completed. These advances, or progress payments, were generally made on Friday for work performed during the week. Advances drawn by applicators were against labor already performed and not against labor to be performed. The amounts of such advance payments were later credited against the total amount due the applicator upon completion of a job.

**28.** Plaintiff usually paid an applicator by check drawn to his order alone. Infrequently, plaintiff would write more than one check where more than one applicator was working a job, but the general practice was to issue and deliver only one check. The recipient applicator would then pay the helpers and split the balance with his partner-applicator, if he had one.

**29.** Plaintiff desired that mechanics carry their own workmen's compensation and liability insurance, and at least three of them did so. Plaintiff paid the premiums for those applicators who did not carry such insurance themselves in order to protect itself. However, in an indemnity-type agreement executed by some applicators, they agreed to hold plaintiff harmless from liability under any claim made against plaintiff by the applicators' employees.[5]

[5] In this agreement the plaintiff is referred to as the "Contractor" and the applicator is referred to as the "Subcontractor". Except for this agreement, which was not in effect during the entire period involved, there was no written agreement between plaintiff and the applicators defining their relationship.

Plaintiff provided no group hospitalization or any other type of employee benefit plan such as vacation or year-end bonus plans. It did not pay unemployment insurance to the State of Maryland on its several applicators.

**30.** Some applicators were licensed contractors operating under licenses issued by the State of Maryland. None of the applicators were members of a labor union.

**31.** The Internal Revenue Service made a determination that plaintiff's salesmen and mechanics were common law employees and assessed the plaintiff for the employment taxes which it asserted should have been withheld, a portion thereof matched, and the total paid to defendant.

**32.** Plaintiff made payments to the defendant of Federal Insurance Contribution Act taxes (FICA) Federal Unemployment Taxes (FUTA), and Income Withholding Taxes in the following amounts for the periods indicated:

| | *1968* | *1969* |
|---|---|---|
| FICA | $1,018.88 | $1,679.72 |
| FUTA | 50.00 | 50.00 |
| Withholding | 50.00 | 50.00 |

Plaintiff then filed timely claims for refund of these taxes, which claims the defendant disallowed.

**33.** Plaintiff timely filed this suit on December 6, 1972. Defendant filed a counterclaim on March 25, 1974, which was based on the compensation paid to the salesmen, the stone mechanics, and the siding applicators. For purposes of trial, the defendant has dismissed the counterclaim with respect to the salesmen and stone applicators, leaving only the employment status of the siding applicators at issue.

ULTIMATE FINDINGS OF FACT

**34.** The applicators were skilled and experienced craftsmen who possessed the ability, without supervision or direction, to perform the work required by the specifications contained in the work orders.

**35.** The applicators performed their work on their own time schedule, selected their own help, and chose their own partners in the course of performing the contract jobs.

**36.** All applicators owned and furnished at considerable expense their own tools, equipment, and transportation vehicles without reimbursement therefor by the plaintiff.

**37.** All applicators were paid on a per job basis at rates negotiated with the plaintiff. The rates of payment differed among the applicators for the same work depending upon their prior record with plaintiff and plaintiff's need for their services from time to time.

**38.** They were free to accept or reject jobs as they chose, and as opportunities presented themselves would perform jobs on their own account and for plaintiff's competitors.

**39.** Other than being expected to follow work order requirements of a kind usually contained in siding application specifications so that the job would be accomplished in accordance therewith, the applicators received no instructions from the plaintiff as to the method or manner in which the work was to be done, plaintiff's main interest being ultimate satisfaction of its customers.

**40.** In only one instance was an applicator's work terminated during its progress. If plaintiff was dissatisfied with the work of a particular applicator, it would simply not offer him another work order.

**41.** Plaintiff had the right to control only the result to be accomplished by the applicators. It did not have the right to control the manner and method in which the work was to be performed.

## CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment is entered to that effect, with the determination of the exact amount of recovery to be reserved for further proceedings under Rule 131(c) in accordance with this opinion. Defendant's counterclaim is dismissed.

# CONGRESSIONAL REFERENCE

(The following Report was filed pursuant to the Act of October 15, 1966, 80 Stat. 958, providing for the reporting of congressional reference cases by commissioners of the Court of Claims)

---

## JOHN J. YARNALL v. THE UNITED STATES

[Cong. Ref. No. 2–72. Filed November 16, 1976]

REPORT TO THE UNITED STATES SENATE

**Congressional reference; civilian pay; voluntariness of resignation; refusal to accept transfer; limitation of actions; laches.**—This congressional reference was referred to the Chief Commissioner of this court by S. Res. 329 (92d Cong., 2d Sess.), pursuant to 28 U.S.C. §§ 1492 and 2509. On December 3, 1951 claimant was given an indefinite appointment as a textile inspector in the Philadelphia Regional Office, Quality Control Section of the Eastern Air Procurement District, New York City, and was assigned to a plant station in Philadelphia. His principal responsibility was to inspect for contract compliance the quality control procedures of Government textile contractors. On an inspection trip to Virginia claimant noticed that sulphur dyestuffs were being used to dye parachute fabrics, which substance eventually deteriorates the fabric in storage. Upon his return to Philadelphia, he notified his immediate superior of this hazard. On September 29, 1952 claimant was notified that he would be permanently transfered within 10 days to a station in Baltimore, with his actual duty station at Richmond. The proposed transfer would have entailed weekly inspection trips out of Richmond of 3 or 4 days' duration each, and return to inspect work in Richmond on Friday. Claimant objected to the transfer because he disliked the southern area, he would receive only a mileage allowance, but no per diem, and the transfer would interfere with his educational program. (Claimant would have been entitled to per diem for qualifying trips *beyond* the Richmond duty station.) Although claimant at first refused the transfer, on December 11, 1952 he notified the regional office that he would accept the same. On January 5, 1953 claimant was informed that his duties would include inspection of parachute packaging, to which he objected on the ground of lack of qualifications. However, consistent with his job description, a textile inspector's duties included packaging of

the finished product. Claimant refused to accept the transfer on these terms, and resigned effective December 31, 1952. Claimant seeks back pay and retirement annuities based upon an alleged coerced resignation. On November 16, 1976 the Review Panel made its report to the United States Senate adopting the trial commissioner's findings of fact and concurring in his opinion and conclusions that the claim is barred by the 6-year statute of limitations (his claim having accrued at the time of his resignation) and by his failure to exhaust available administrative remedies, and that no facts exist warranting tolling of the statute. Nor does any circumstance exist which would equitably extenuate or excuse claimant's complete failure for 18 years to take any steps to redress what he erroneously conceived to be a legitimate grievance. Claimant has no legal or equitable right to payment and any payment would be a gratuity.

**Congressional reference; limitation of actions/laches.**

[1] The congressional reference statute requires the trial commissioner and the review panel to consider any facts which, in good conscience, would warant removal of the 6-year statute of limitations. Where the period of limitations has expired, the doctrine of laches has no application. If the laches defense is timely raised and not waived, and facts properly found show that the Government is prejudiced by destruction of records, death, unavailability of key witnesses, or duplication of salary payments, the right to have a claim adjudicated may be barred even though the delay is substantially less than the period of limitations.

**Civilian pay; administrative remedies; failure to exhaust.**

[2] Pursuit and exhaustion of available administrative relief is a mandatory prerequisite to judicial review. Failure to exhaust such administrative relief is in itself an effective bar to any legal rights absent mitigating circumstances.

**Civilian pay; reassignment; refusal to accept transfer.**

[3] The personal inconvenience to a Government employee that a geographical transfer of his duty station will interfere with his educational program is no justification for his refusing the transfer, for the needs of the service are paramount. The employee's only recourse is to accept or resign, unless the motivation for the transfer is shown to be for reasons other than the efficiency and needs of the service.

**Pleading and practice; defenses; failure to brief or argue.**

[4] The defenses of laches and failure to exhaust administrative remedies are affirmative defenses which must be expressly pleaded.

## ALASKA NATIVE CLAIMS SETTLEMENT ACT

Upon consideration of the trial commissioner's opinion, findings of fact, and conclusion in each of the below-identified cases, the Review Panel has filed its respective opinion In Re Attorneys Expense Claims and Consultant Claims pursuant to Sec. 20 of the Alaska Native Claims Settlement Act, Pub. L. 92–203, 85 Stat. 688, 710.

ATTORNEYS EXPENSE CLAIMS

| Attorneys | Alaska Client | Review Panel Amount Allowed |
|---|---|---|
| Wyman, Bautzer, Rothman & Kuchel, No. F–2. | Alaska Federation of Natives. | $3, 261. 86 |
| Paul, Weiss, Rifkind, Wharton & Garrison, No. F–3. | Alaska Federation of Natives. | 29, 415. 75 |
| Culp, Dwyer, Guterson & Grader, No. F–4. | Alaska Federation of Natives. | [1] 1, 488. 28 |
| Weissbrodt & Weissbrodt, No. F–13. | Tlingit and Haida Indians of Alaska. | 1, 534. 47 |
| Roger G. Connor, No. F–23. | Aleut Community of St. Paul Island and the Aleut Tribe. | [1] 2, 593. 42 |
| Belli, Ashe, Ellison & Choulos, No. F–24. | Nondalton-Lime Hills Indians of Alaska. | ([2]) |
| John W. Hendrickson and Hendrickson & Rowland, No. F–29. | Native Village of Unalakleet, Alaska, and Bering Straits Native Ass'n. | 2, 602. 37 |

[1] Lower than trial commissioner's recommendation.
[2] Claim dismissed.

CONSULTANTS CLAIMS

| Consultants | Alaskan Client | Review Panel Amount Allowed |
|---|---|---|
| Innova Corporation,[3] No. F–9. | Arctic Slope Native Ass'n. | $7,600.00 services.<br>173.13 expenses. |
| Guy G. Gordon, No. F–10.[3] | Arctic Slope Native Ass'n. | 3,200.00 services. |
| Adrian Parmeter, No. F–19. | Alaska Federation of Natives, and Arctic Slope Native Ass'n. | 11,975.00 services (see comments below). |
| Cornell, Howland, Hayes & Merryfield, Inc., No. F–20. | Aleut Tribe and Aleut Community of St. Paul Island. | 1,148.82 services. |
| Paul T. Dixon, d/b/a Paul T. Dixon & Associates, No. F–27. | Association of Village Council Presidents. | [3] 28,400.00 services.<br>500.00 expenses. |

[3] Because the trial commissioner allowed total fee claims for all consultants in the sum of $156,214, while Congress provided for a maximum of only $100,000, pursuant to Sec. 20(d)(4) he prorated each of the allowances. For the reasons set forth in the review panel's opinion on the consultant claim of Adrian Parmeter, No. F–19, the review panel is of the view that the proration herein is in error. The amount of all consultant claims allowed by the trial commissioner is at least $187,488 and the proportion which $100,000 bears to $187,488 is 53.3%, rather than the 64% allowed by the trial commissioner.

Re: *Adrian Parmeter, No. F–19*

The opinion of the majority of the review panel in case No. F–19 discusses "the existence of a bona fide attorney-client relationship with an identifiable client" as provided in Sec. 20(d)(2) of the Alaska Native Claims Settlement Act, the limitation on the amount of compensation as provided in Sec. 20(d)(4), and whether the Alaskan organizations in question expressly, or impliedly, obligated themselves to the claimant in excess of the amounts already paid in the

event they or their members should receive, directly or indirectly, payment of the native claims from Congress. The review panel concluded from a preponderance of the evidence that the claimant has not shown either that Mr. Wright (the President of the Alaska Federation of Natives (AFN)) had the authority to agree on AFN's behalf to obligate it or its members to additional compensation out of the funds that they might receive from land claims settlement legislation or that AFN ratified such an agreement or even approved any future effort by claimant to obtain additional compensation from the statutory fund for the services that he had rendered AFN and for which he had received money. The record does support claimant's claim for per diem compensation for 12 additional days of work for which AFN omitted to pay him totalling $1,500.00. The panel also concluded that the evidence establishes an obligation by the Arctic Slope Native Association that claimant should be paid reasonable compensation for services rendered at the time the land claim settlement legislation was passed, and it accepts claimant's own assessment of the value of his services to the latter association, viz. $17,250.00. Combining this amount with the $1,500, claimant is entitled to $18,750; and deducting the amount claimant has already received from the latter organization, the net amount allowed is $11,975.00.

On January 11, 1977 the review panel filed an opinion on claimant's request for reconsideration, reading as follows:

Claimant has filed a request for reconsideration of the review panel's opinion of November 4, 1976, together with affidavits by himself, Jerome Trigg, Tim Wallis, Harvey Samuelson and Frances Degnan; and Attorneys Edward Weinberg and Frederick L. Miller have submitted a brief amicus curiae on behalf of the Alaska Federation of Natives (AFN) in support of the motion.

Claimant's averment that "the Review Panel majority opinion of November 4, 1976 constitutes, in effect, the first written statement of opposition to this claim" is not an accurate statement. The review panel's order and opinion on trial commissioner's opinion, findings of fact, and conclu-

sions, filed May 28, 1975, gave claimant precise notice of the deficiencies it found in his claim.

Claimant does not allege that the testimony of the five affiants represents newly discovered evidence not reasonably available to him at the time of trial, nor does he otherwise justify his failure to offer that testimony at trial. At the minimum, such a showing is required for retrial or reconsideration on the basis of additional evidence. *Pickford* v. *Talbott*, 225 U.S. 651, 660 (1912).

The standard to be applied in evaluating the propriety of petitions for reconsideration is set forth in *General Electric Co.* v. *United States*, 189 Ct. Cl. 116, 117–18, 416 F. 2d 1320, 1321 (1969):

> * * * [W]here a party adversely affected by the court's decision on the issue has had fair notice that the question may well be in the case, has had a fair chance to present its position, has failed to do so, and gives no sufficient excuse for its failure, a demand for post-decision relief will normally be rejected. * * *

And in *Nossen* v. *United States*, 191 Ct. Cl. 198, 204, 422 F. 2d 1340, 1343 (1970):

> Any court is necessarily concerned when a responsible attorney alleges that it has reached an incorrect result because of a mistaken determination of the facts of a case. However, the facts in any litigation must be decided on the basis of the evidence produced by the litigants in that particular case. It may well be that if the case were retried, the Government could present a stronger and more effective defense, but to make a litigation an open-end proposition jeopardizes the confidence which litigants can place in a court's ability to render final judgment. * * *[1]

And *see also Mason & Hanger Co.* v. *United States*, 207 Ct. Cl. 183, 523 F. 2d 1384 (1975); and *Technical Development Corp.* v. *United States*, 202 Ct. Cl. 237, 314 (1973), *cert. denied*, 416 U.S. 983 (1974).

Although claimant does not meet the standards for reconsideration, to avoid any possibility of injustice the review

[1] Quoting from concurring opinion of C. J. Cowen in *Kaiser Aluminum & Chemical Corp.* v. *United States*, 137 Ct. Cl. 443, 456–57, 409 F.2d 238, 245 (1969).

panel has carefully reviewed the claimant's current submissions and the portions of the record adverted to therein.

The review panel is not persuaded that it has erred with respect to its interpretation of the statute or any other matters of law set forth in its opinion.

With respect to the period prior to April 24, 1971, none of the submissions tend to impair in any way the review panel's conclusion from the record, including claimant's own testimony, that his employment at any fee in excess of what he was paid was not approved by the Board of Directors of AFN as required by its bylaws.

With respect to the period from April 24 to December 18, 1971, the submissions also fail to show that the review panel erred in concluding that claimant's contract with AFN was as stated in the motions and resolutions of April 24, 1971 and June 20, 1971, *i.e.*, to "retain Mr. Parmeter at $125.00 per day, 5 days a week for 2 months," "to hire Adrian Parmeter at $125.00 per day," and to "retain Adrian Parmeter at $100.00 per day for 3 months." The affidavits of Jerome Trigg, Tim Wallis, Harvey Samuelson, three of the approximately 28 members of the board, and of Frances Degnan, the secretary, as to their individual understandings that claimant would receive more from the proceeds of the enactment, is not persuasive that the board as an entity contracted with claimant to obligate AFN or its successors in interest to the fund for any amount in excess of the fee at which it retained or hired claimant. This is particularly true in the light of the inability of Donald Wright, former president of AFN and claimant's sponsor, to answer flatly the question, "What was the understanding of the Board members as to whether or not the $125 per day to Mr. Parmeter was to be his full compensation?" His considered response was that in his opinion some thought that it was to be his full compensation and others closer to Wright thought it was not. Nowhere did he or anyone else state that the board actually agreed to fees in excess of the rate at which the board's resolution stated he was hired.

The amicus curiae brief appears to consist mainly of arguments of counsel from the record which the review panel

has already thoroughly considered. It does not bring to our attention any additional evidence which would have been admissible on behalf of claimant even had it been timely presented at trial.

IT IS THEREFORE ORDERED that claimant's request for reconsideration is denied.

---

HARKINS, *Commissioner*, concurring in the result:

I concur only in the conclusion that claimant's request does not satisfy the requirements for post-decision relief.

# ORDERS

No. 102–63. NOVEMBER 12, 1976

Jessie Short, et al.

*Pleading and practice; pretrial procedure; discretion of trial judge.*—On November 12, 1976 the court entered the following order:

*Harold C. Faulkner*, Attorney for Certain Plaintiffs. *William C. Wunsch*, *Wallace Sheehan*, *Faulkner*, *Sheehan & Wunsch*, *Heller*, *Ehrman*, *White & McAuliffe*, of counsel.

*Herbert Pittle*, with whom was *Assistant Attorney General Peter A. Taft*, and *Jerry C. Straus*, for defendant and defendant-intervenor. *Wilkinson*, *Cragun & Barker*, *Alan I. Rubenstein*, *Michael B. Green*, *Mandich*, *Clark & Barker*, and *Wesley L. Barker*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and BENNETT, *Judges*.

"This case comes before the court on a request, filed September 13, 1976, by defendant United States and defendant-intervenor, the Hoopa Valley Tribe of Indians, for review of the trial judge's order of September 3, 1976. The thrust of the request is that the trial judge has changed in midstream the pretrial procedural requirements previously ordered by him. The request observes that those requirements have been substantially complied with at a great expenditure of time and finances by defendants, but that the trial judge would by his order now permit certain plaintiffs to avoid, or at least delay, the filing of replies to defendants' response, except as to legal issues deemed pertinent to prospective motions for summary judgment. Claimants surviving such motions would have to file replies later on the factual issues which are disputed.

"The court, having considered the strong representations made in the request for review, appreciates the concerns upon which the request is predicated. However, we conclude that in a proper exercise of his discretion in handling pretrial matters under the rules of the court (Rules 12 and 112), the trial judge must have considerable latitude to apply that discretion to handle a case, especially a large case such as this one with several thousand claimants. We do not believe that he has abused his discretion in altering the sequence of pretrial proceedings to fit developments which they have revealed as they have been pursued. In the long run, we do not believe that the defendants will be prejudiced by this order, although in the immediate posture of the case it does result in some parties bearing a greater preliminary burden than others. Upon consideration of the request for review, the response, and all supporting papers, without oral argument,

"IT IS THEREFORE ORDERED that the request for review is granted but that upon review the order of the trial judge entered September 3, 1976, is affirmed."

---

No. 102–63. NOVEMBER 12, 1976

Jessie Short, et al.

*Pleading and practice; trial judges; authority of trial judges; dispositive motions, directions to file.*—On November 12, 1976 the court entered the following order:

*Harold C. Faulkner*, Attorney for Certain Plaintiffs. *William C. Wunsch*, *Wallace Sheehan*, *Faulkner*, *Sheehan & Wunsch*, *Heller*, *Ehrman*, *White & McAuliffe*, of counsel.

*Herbert Pittle*, with whom was *Assistant Attorney General Peter A. Taft*, and *Jerry C. Straus*, for defendant and defendant-intervenor. *Wilkinson*, *Cragun & Barker*, *Alan I. Rubinstein*, *Michael B. Green*, *Mandich*, *Clark & Barker*, and *Wesley L. Barker*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and BENNETT, *Judges*.

"This case arises on a request for review by defendant United States and defendant-intervenor, the Hoopa Valley

Tribe of Indians, of an order by the trial judge entered October 8, 1976, reaffirming his order of May 26, 1976. The latter order mandated that the defendants and the plaintiffs file motions for summary judgment on a schedule of dates outlined therein. The trial judge had previously entered orders which required defendants to respond to certain declaration-questionnaires filled out by plaintiffs to show their entitlement to recovery and required plaintiffs to reply thereto. Many of these papers having been submitted, the trial judge concluded that it would contribute to the good order of handling these claims—almost 4,000 in number—for the defendants to file motions for summary judgment where the responses suggested that legal issues might lead to disqualification of some plaintiffs, or for plaintiffs to so file where claimed eligibility was substantially uncontroverted within the interpretation of the opinion of the court in *Short* v. *United States* on October 17, 1973 (202 Ct. Cl. 870, 486 F. 2d 561, *cert. denied*, 416 U.S. 961 (1974)). Certain plaintiffs were relieved by an order on September 3, 1976, from filing replies until resolution of these dispositive motions clarified the situation. Plaintiffs, on September 1, 1976, filed two motions for summary judgment pursuant to said order of May 26, 1976, but defendants challenge the requirement to do so, alleging no authority in the trial judge to require the filing of a dispositive motion, alleging, alternatively, that his order was actually permissive and not mandatory, and, finally, that the order, if enforced, will shift the burden of proof in this adversary proceeding improperly to defendants. The trial judge has certified the request for review to us for consideration as one of controlling importance to the conduct of the case. Rule 53(c)(2)(i).

"While Rule 101(b) of the Court of Claims is permissive in its tenor and provides that a defendant may move for summary judgment, we hold that it must be considered in connection with Rule 13 which gives the trial judges the widest latitude in proper exercise of their discretion to regulate proceedings before them, subject to review by the court. We find no abuse of that discretion in his order requiring defendants to test out the legal defenses they have raised which, if

successful, will resolve many of the claims without further pretrial efforts to develop factual issues. Further, the language of the underlying order of May 26, 1976, is clearly mandatory. It says defendants "are directed" to file motions for summary judgment, and sets a date therefor. Nor do we agree that this procedure shifts the burden of proving plaintiffs' claims to defendants. What is at issue is the legal validity of criteria proposed by defendants to defeat the claims. It is not an uncommon practice in this and in other courts for such legal issues to be resolved, where dispositive, in advance of adjudication of issues on the merits. Upon consideration of the request for review, plaintiffs' response, and defendants' reply, without oral argument,

"IT IS THEREFORE ORDERED that the request for review is granted but that upon review the order of the trial judge entered October 8, 1976, is affirmed. The parties are instructed to comply with the directions of the trial judge in filing dispositive motions pursuant to such a time schedule as he requires.

"IT IS FURTHER ORDERED that the orders of the court of October 1 and October 18, 1976, directing that the trial judge rule in the first instance on any then pending dispositive motions, be and they are amended to include reference to him, pursuant to Rule 54, of any and all such motions now or hereafter filed in this case, subject to review as provided by the rules."

---

No. 453–73. NOVEMBER 12, 1976

Hart Metal Products Corporation

*Taxes; personal holding company income; interest on tax deficiency.*—On November 12, 1976 the court entered the following order:

*John L. Carey*, attorney of record, for plaintiff. *Stephen A. Seall*, *Tornburg*, *McGill*, *Deahl*, *Harman*, *Carey & Murray*, of counsel.

*Robert S. Watkins*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *William Kalish*, of counsel.

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

"This tax refund case comes before the court on the parties' stipulation of facts and legal arguments. Before the case was submitted, the parties compromised the entire case except for the issue which concerns the question of whether interest on the personal holding company tax deficiency accrues from the due date of the tax return or from the subsequent date of the notice and demand by the Internal Revenue Service. That issue alone remains for resolution by the court.

"On that question the taxpayer claims that the personal holding company tax is an 'additional amount' or 'addition to the tax, within § 6601(f)(3) (as it was then numbered) of the Internal Revenue Code so that no interest began to accrue with respect to taxpayer's personal holding company tax deficiencies prior to notice and demand. We held, however, in *Motor Fuel Carriers, Inc.* v. *United States*, 190 Ct. Cl. 385, 392–94, 420 F. 2d 702, 707 (1970), that § 6601(f)(3) applies only to such additions which need an administrative determination by the Service before the taxpayer can know that he is liable for them. We also indicated explicitly that the personal holding company tax (unlike the accumulated earnings tax) falls outside that category; 'that tax [*i.e.*, the personal holding company tax] is reportable on the return, is meant to be so reported, and is treated as self-assessable.' 190 Ct. Cl. at 394, 420 F. 2d at 708. A taxpayer is clearly required to report (on its return) personal holding company income and to pay the personal holding company tax with its return. Interest therefore runs, under § 6601(a) of the Code, from the date of the return. This taxpayer, having paid interest from that date, is not entitled to recover.

"IT IS THEREFORE ORDERED that plaintiff is not entitled to recover on the only part of its claim which remains before the court, and that the case is returned to the Trial Division to be held until the compromise of the other aspects of the case is effectuated, and then the petition is to be dismissed."

On December 28, 1976 a stipulation for dismissal was filed, and on the same date the petition was dismissed as to counts I, III, IV, VI, VII and IX pursuant to Rule 102(a)(1)(iii).

No. 298–74. NOVEMBER 12, 1976

Aerojet-General Corporation

*Contracts; Truth in Negotiations Act; duty to disclose true costs.*—Plaintiff seeks Wunderlich Act review of a decision of the Armed Services Board of Contract Appeals holding that the Government was entitled to a reduction in the contract price negotiated for a change order. The Board's decision flowed from its ultimate finding that in the course of negotiating the change order plaintiff failed to disclose to the Government current, accurate and complete cost or pricing data as required by the Truth in Negotiations Act, 10 U.S.C. § 2306(f). On August 10, 1976 Trial Judge Lloyd Fletcher filed a recommended decision (reported in full at 22 CCF para. 80536) in which he agreed with the Board's decision except for its quantum determination. As to the latter, the Board's acceptance of the contracting officer's recomputation is fully supported by substantial evidence in the record with the exception of elimination of a 4% profit previously allowed for risk on the 70% portion of the contract already completed; it was not proper for the contracting officer and the Board to ignore the agreement between the parties that plaintiff was entitled to a 12% profit since the agreement was not directly connected with the failure to furnish accurate, complete and current cost data. The trial judge recomputed the reduction in contract price found by the Board ($231,771) and arrived at the figure of $214,598. This case came before the court on plaintiff's motion moving that the court adopt the recommended decision. On November 12, 1976, by order, the court granted plaintiff's motion, adopted the recommended decision as the basis for its judgment in this case, ordered that, since the Government has already recovered $231,771, whereas it was entitled to only a reduction of $214,598, plaintiff is entitled to judgment in the amount of $17,173, entered judgment in that amount, and dismissed the petition.

No. 414–74. NOVEMBER 12, 1976

Versitron, Inc.

*Taxes; income tax; small business status; tax-free merger with another; reinstatement of small business status; consent of Commisioner.*—On November 12, 1976 the court entered the following order:

*Melville W. Feldman*, attorney of record for plaintiff. *Feldman & Sheehan*, of counsel.

*George L. Squires*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"The Government seeks judgment on the pleadings in this taxpayer's suit for a refund of income taxes that would not have been collected had petitioner been permitted to re-elect its former status under Subchapter S of the Internal Revenue Code. For the reasons set forth below, we grant the motion.

"For taxable years prior to 1970, petitioner elected to be taxed as a small business corporation under §§ 1371–79 of the Internal Revenue Code. In that year, however, petitioner automatically lost its Subchapter S status when it merged with Aiken Corporation by means of a tax-free exchange of stock governed by IRC § 368(a)(2)(B). After the petitioner had operated for two years as a subsidiary of Aiken's its former owners and the parent corporations decided to undo the merger, and accomplished a tax-free divestiture of petitioner under IRC § 355. We notice that petitioner, though using the word 'recision,' does not allege that the merger was rescinded in 1972 *nunc pro tunc*, but only that the corporate partners were then divorced. In any event, since 1972 petitioner has operated as an independent corporation, owned in the same proportions by those who had owned the corporation prior to the merger. In 1972, petitioner sought to recover its Subchapter S status.

"Section 1372(f) of the Code provides that after a small business corporation's status has been terminated, the consent of the Commissioner of Internal Revenue is required before that corporation may resume such status within five years of the termination. In order to implement its discretion in giving consent, the Internal Revenue Service has promulgated Regulation § 1.1372–5, which provides taxpayers and revenue agents with the following guidance:

> First, the taxpayer will bear the burden of establishing that the Commissioner should consent.
>
> Second, the fact that more than half of the taxpayer's stock is held by those who had held no stock prior to termination of Subchapter S status will tend to establish that consent should be granted.
>
> Third, in other circumstances consent will generally be denied unless the cause of the termination was not under the control of the electing shareholders.

"Petitioner twice sought reinstatement of its Subchapter S status, but on each occasion, after reciting the facts of this case, the IRS denied petitioner's request on the grounds that the facts outlined in the regulation did not appear in the case. Petitioner now contends that the Service's decisions were arbitrary and capricious, apparently because petitioner believes that the Service gave inadequate consideration to the fact that the cause of the termination in 1970, the merger, was reversed in 1972. Petitioner argues, in short, that since the business arrangement that cost it its favorable tax status was undone, the Commissioner is bound to permit petitioner to revert to the *status quo ante*.

"Whatever may be its general appeal, petitioner's situation does not compel the conclusion that the Commissioner abused his discretion in denying petitioner reinstatement of Subchapter S status. 'To make this finding [that an agency's decision is arbitrary, capricious, or an abuse of discretion] the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.' *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971). Here, however, there is no doubt that the Commissioner was aware of all the facts that petitioner alleges were relevant; the facts, as peti-

tioner alleged them, appear in the Service's letters of denial. The Service based its decisions on petitioner's statements, including for example, the conclusory allegation that the 1972 agreement to corporate separation had the effect of reversing and rescinding the 1970 reorganization. Still, the Commissioner decided not to consent to re-election. That the Commissioner eventually found that the divestiture of petitioner was not itself sufficient, in the absence of the circumstances outlined in Reg. § 1.1372–5, to justify a decision favorable to petitioner does not imply arbitrary or capricious conduct. Petitioner would have us weigh for ourselves the facts and circumstances before the Commissioner and determine what his decision should have been. But our limited scope of judicial review of an administration decision is not that broad.

"Petitioner next points out that if it and Aiken had chosen a different route of reorganization in 1970, there would have been more favorable tax consequences now, and that our decision should follow the substance of the transaction and not its form. Petitioner is correct insofar as if it had joined with Aiken either by a statutory merger, IRC § 368(a)(1)(A), or by a transfer of assets, IRC § 368(a)(2)(C), it would not have lost its Subchapter S status. And, indeed, it is a principle of tax law that tax consequences should flow from the economic reality of a transaction, and not be misdirected by form that reflects little of the substance. *See, e.g., Grinnell Corp.* v. *United States*, 182 Ct. Cl. 702, 725, 390 F. 2d 932, 944 (1968); citing *Commissioner* v. *Court Holding Co.*, 324 U.S. 331 (1945).

"Yet, where a taxpayer chooses one alternative over another for one purpose, our court has held that he cannot disavow that device for another purpose. *W. W. Fertilizer Corp.* v. *United States*, 208 Ct. Cl. 443, 527 F. 2d 621, 625–26 (1975), *cert. denied*, 425 U.S. 974 (1976). In support of that holding, the court quoted the Supreme Court's statement in *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 at 149 (1973):

> * * * While a taxpayer is free to organize his own affairs as he chooses, nevertheless, now having done so, he must accept the tax consequences of his choice, whether con-

> templated or not, * * * [citations omitted] and may not enjoy the benefit of some other route he might have chosen to follow but did not.

For reasons of its own, which it is reasonable to assume were dictated by business exigencies at the time of the consolidation, petitioner chose an exchange of stock, IRC § 368(a)(2)(B), and acquiesced in foregoing its Subchapter S status. We hold that petitioner is bound, under these authorities, to the consequences of that choice.

"Finally, petitioner urges us to conclude from the legislative history behind the enactment of § 1372(f), S. Rep. No. 1983, 85th Cong., 2d Sess. 89, that the Commissioner disregarded Congressional intent in denying petitioner's request. Section 1372(f) aims to prevent taxpayers from electing 'in and out' of favorable tax status by imposing a 5-year waiting period during which a corporation that had relinquished its Subchapter S status may not reassume it without the Commissioner's consent. The statute contemplates, though, that the Commissioner might recognize in certain circumstances the feared result would not occur, and that the waiting period might be shortened or waived altogether. Thus, Congress conferred discretion upon the Commissioner to review the facts of particular cases. From the record, we cannot deny that the Commissioner was aware of the peculiarities of this petitioner's situation. On the other hand, however, the Commissioner had before him substantial evidence justifying the conclusion that the taxpayer relinquished favorable tax status when that was convenient, and now wishes to recapture it, in circumstances not visualized by the Congress, so far as is known, as justifying an exception to the five year waiting period. Where the Commissioner's decision is supported by substantial evidence, we are required to affirm it. This is not to say that a decision in favor of the taxpayer would have been an abuse of discretion either.

"Lastly, petitioner attempts to forestall summary judgment disposition of this case by offering to raise *de novo* issues of fact 'relating to the competency and authority of the persons who denied plaintiff's request for consent in the name of the Commissioner.' This contention appears for the

first time in petitioner's papers filed in this court. Accordingly, petitioner is barred from raising this contention because it failed to include it in any claim for refund filed with the IRS. *Cataphote Corp. of Mississippi* v. *United States*, 210 Ct. Cl. 125, 149, 535 F. 2d 1225, 1239 (1976).

"Therefore, upon consideration of the pleadings, defendant's motion for judgment on the pleadings and petitioner's opposition thereto, and the briefs and representations of the parties but without oral argument, it is ORDERED that the motion for judgment on the pleadings be granted. The petition is dismissed."

Plaintiff's motion for rehearing and reconsideration *en banc* was denied January 7, 1977.

---

No. 434–74. NOVEMBER 12, 1976

Clifford B. Adams

*Military pay; active duty agreements; release from duty.*—On November 12, 1976 the court entered the following order:

*Maurice F. Biddle*, attorney of record, for plaintiff. *Thomas H. King*, of counsel.

*Frank H. Clabaugh*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This military pay case comes before the court under our Rules 134 and 143 on facts jointly stipulated.

"Plaintiff, a reserve officer, seeks to have this court enter an order directing the Secretary of the Air Force to revoke plaintiff's transfer to the retired reserve and to order plaintiff restored to active duty status until December 31, 1977. Plaintiff contends that he had a contract with the U.S. Air Force, that pursuant to that contract the Government was obligated to retain plaintiff on active duty until he reached age 60 and retired, and that defendant breached that contract by releasing plaintiff to inactive duty prior to his reaching age 60.

"Plaintiff's contractual theory ignores the well-established principles that there is no vested right to Federal employment and that a soldier's status is created entirely by statute and can be altered or taken away by statute. *Bell* v. *United States*, 366 U.S. 393, 401 (1961); *Norman* v. *United States*, 183 Ct. Cl. 41, 49, 392 F. 2d 255 (1968).

"The controlling statutory language governing the release of reserve officers from active to inactive duty is found in 10 U.S.C. § 681 which provides in pertinent part that:

> (a) * * * the Secretary concerned may at any time release a Reserve under his jurisdiction from active duty.

"Reserve officers, such as the plaintiff, do not possess indefinite commissions and can under § 681(a) be released from active duty at any time. *Denton* v. *United States*, 204 Ct. Cl. 188, 200 (1974), *cert denied*, 421 U.S. 963 (1975). The conditions and circumstances governing that release rest within the sound discretion of the service. *Abruzzo* v. *United States*, 206 Ct. Cl. 731, 737, 513 F. 2d 608, 611 (1975).

"By letter plaintiff was informed by the acting director of the Selective Service System that "[d]ue to budgetary and authorization limitations" he would be released from active to inactive duty. As a result of the recommendation of the Selective Service System, the Secretary of the Air Force directed that plaintiff be released from active duty. We find that in the case at issue, the Secretary of the Air Force exercised the discretion granted to him by 10 U.S.C. § 681.

"Plaintiff has failed to establish that his active duty with the Air Force was contractual in nature. Rather, we find that plaintiff's service was predicated upon and governed by statutes and that plaintiff's release from active to inactive duty was accomplished in accordance with those statutes. Therefore,

"IT IS ORDERED that plaintiff's motion for summary judgment be and is hereby denied, that defendant's cross motion for summary judgment be and is hereby granted, and that plaintiff's petition be and is hereby dismissed."

No. 81-75. NOVEMBER 12, 1976

Elizabeth P. Stubbs

*Taxes; estate tax; marital deduction; decedent's intent; sale of mature southern pine trees.*—On November 12, 1976 the court entered the following order:

*Louis A. Thompson*, attorney of record for plaintiff. *Thompson & Benken*, of counsel.

*David C. Hickman*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"The Government seeks summary judgment in this executrix's suit for a refund of estate taxes that would not have been collected if the Internal Revenue Service had allowed the estate's claim to a larger marital deduction.

"Until his death, decedent owned 2,300 acres of timberland in Georgia. Decedent's will bequeathed to his wife 'all of my real estate for her use and during her lifetime, and until such time as she may remarry.' At the expiration of the widow's life estate the real estate would pass to the decedent's daughter for life, with a remainder in 'all my said lands' to decedent's grandchildren. Internal Revenue Code § 2056 governs the marital deduction for computing the taxable value of an estate for estate tax purposes. In essence, the Code allows a deduction from the gross estate for the value of any nonterminable, noncontingent property interests that pass to the decedent's surviving spouse. Plaintiff claimed no marital deduction for the widow's interest in the timberland on the first estate tax return filed.

"Later, however, plaintiff claimed, as she does in this suit, that the proceeds the widow received from the sale of trees already mature at the time of decedent's death qualify for the marital deduction. Plaintiff maintains that she can prove either (1) that these merchantable trees were an identifiable interest separately bequeathed in fee to the widow, so that the proceeds of the sale are a nonterminable bequest under § 2056, or (2) even if the trees are deemed to have been be-

queathed in life estate only, that the proceeds from cutting represent the commuted value of the life estate in the fashion regarded as nonterminable in *Hawaiian Trust Co.* v. *United States*, 188 Ct. Cl. 906, 412 F. 2d 1313 (1969).

"On the first point, the plaintiff intends to show from the decedent's 'acts, deeds and words' his intent to bequeath his widow the exclusive right to cut all the timber during her lifetime. Plaintiff would direct our attention to the peculiarities of timber farming in Georgia that, plaintiff contends, are consistent with this intent. Apparently, Georgia southern pine trees of the type that allegedly inhabit decedent's woodlands grow fastest during the early years of their lives, so long as the mature trees that have reached full growth are timely cut. Future timber crops can be so badly impaired by permitting older trees to remain beyond their productive years that the courts of Georgia have imposed a duty upon life tenants in timberland to cut merchantable trees, in order to protect the interests of the remaindermen. Plaintiff asserts that decedent, however, disregarded this good forestry practice during his life, but chose instead to let old trees stand to provide turpentine. Since decedent owned the woodland in fee, there were, of course, no remaindermen to whom he owed any obligation to harvest mature trees. Plaintiff contends that she can demonstrate decedent's awareness of this situation and his expectation that his widow would be obliged to cut the old trees immediately, so that by operation of Georgia law she would receive an outright gift of these trees. That is why, according to plaintiff, decedent bequeathed to his widow and daughter an interest in 'real estate,' but limited the remainder in his grandchildren to his 'lands,' which we are told refers to the soil alone and not the trees.

"The Government responds that decedent's will clearly devised a life estate in both the timber and the land, which creates a terminable interest under § 2056 not entitled to the marital deduction. The Government cites several authorities that construe the term 'land' in an instrument of conveyance to include the timber thereon, and argues that plaintiff cannot offer evidence to alter the terms of an unambiguous will.

"The Government is quite right that in the context of this will, the term 'my said lands' refers to its antecedent, 'real

estate.' There is no discernible implication that the land and the trees were separately devised. Notable also is the fact that the term 'real estate' appears again in the will when the decedent created the second life estate for his daughter, and 'land' appears only in the fee remainder to the grandchildren. So, even if plaintiff were correct that this semantic distinction implies a severance of the trees from the earth, it would not be the decedent's widow who keeps the trees but his daughter. Defendant is further correct that plaintiff is precluded from altering the will terms. We should, nevertheless, afford plaintiff the opportunity to *explain* the terms of the will with whatever evidence she believes best reflects the decedent's actual intent. Decedent's intent will control in the end, of course, and we ought to make every effort to determine what it might have been before we grant defendant's summary judgment.

"Plaintiff next suggests that even if the widow received only a life estate in the merchantable trees, the proceeds of the sale can be shown to be the commuted value of that estate, for which the marital deduction is allowable under *Hawaiian Trust Co., supra.* The widow in *Hawaiian Trust Co.* elected against the will to take her dower rights under state law, a life estate in one-third of the realty owned in fee by her husband during the marriage. Revenue Laws of Hawaii, 1955, § 319–1. The estate needed to sell the property in order to satisfy debts and to meet expenses, however, and a fair price could not be realized if the property were sold subject to the widow's dower. So the widow agreed to join in the conveyance and to accept from the estate, in lieu of her dower rights, the present value of the life estate, computed in accordance with standard actuarial tables. *Id.* § 319–17. The IRS disallowed the marital deduction, maintaining that the widow's dower was an ineligible, terminable interest regardless of the actual form of settlement. This court, however, held for the taxpayer on the grounds that the widow's dower *right* vested at the time of decedent's death, unlike her dower *estate* which could not arise until the lands were assigned to her possession. Thus, the lump sum in cash paid to the widow in lieu of a vested right, and not in exchange for any terminable estate, qualified for the marital deduction. Our decision relied on

*United States* v. *Crosby*, 257 F. 2d 515 (5th Cir. 1958), which had held in similar circumstances that the cash equivalent of a widow's dower right is excludable from the taxable estate. The *Crosby* court stressed that the sale of property was not by the widow but by the administrators of the estate: the widow did not sell her dower interest but consented to the sale by the administrators. The amount she received was an equivalent ascertained by the court. *Id.* at 519.

"The plaintiff now before us does not allege that the widow exchanged her statutory rights against the estate, or that the estate sold the timber to raise needed cash, or that the value of the widow's interest was appraised with reference to her life expectancy. On the contrary, the widow took possession of the property, made her own bargain for the sale of some timber, from which a market price emerged. All of this may well be enough to distinguish this case from the cited precedents, as the Government urges us to do. The fact that the widow took possession of the timberland as a life tenant raises another very substantial question, whether the proceeds obtained from the sale of timber were any more than the periodic income due the life tenant during possession.

"Still, plaintiff maintains that she can prove facts that will put this case within the authorities that arrive at her desired result. We cannot deny that the determination of whether a transaction represents a realization of income from property or a disposition of the property has often turned on the facts of the particular cases, at least in other areas of tax law. *See*, *McAllister* v. *Commissioner*, 157 F. 2d 235, 237 (2d Cir. 1946), *cert. denied*, 330 U.S. 826 (1947). We cannot deny that this may be the case here.

"Since we are to determine defendant's right to summary judgment as if the facts were found most favorable to plaintiff, we cannot say that there are no facts upon which the plaintiff might prevail. Therefore, defendant's motion for summary judgment is denied."

On January 17, 1977 plaintiff filed a motion to dismiss endorsed "No Objection" by defendant. The petition was dismissed on January 17, 1977 under Rule 102(a)(1)(iii).

No. 182–75. NOVEMBER 12, 1976

Charles L. Meyer

*Military pay; promotions; Court of Claims jurisdiction; finality of decision of Correction Board.*—On November 12, 1976 the court entered the following order:

*Charles L. Meyer, Pro se.*

*Michael J. Rubin*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case comes before the court on plaintiff's motion for summary judgment and defendant's cross-motion for summary judgment. After a thorough reading of the briefs, consideration of the pleadings, and without oral argument, we grant defendant's cross-motion for summary judgment, deny plaintiff's motion for summary judgment, and dismiss plaintiff's petition.

"Plaintiff is a former captain in the United States Air Force Ready Reserve who was separated from that service on August 26, 1971, after having been twice passed over for promotion to major. Plaintiff alleges that he was not selected for promotion to major due to administrative errors in his Officer Effectiveness Reports (OERs). He alleges that these errors violated certain Air Force regulations.

"After being notified of his nonselection for promotion to major in January 1969, plaintiff reviewed his personnel records at the Air Reserve Personnel Center in Denver, Colorado. He claims that he then noticed for the first time certain alleged administrative errors in his OERs. His name was incorrectly spelled on one; the incorrect reporting official prepared two; and there were material misstatements and pertinent omissions on the remaining two.

"In October 1969, plaintiff filed an application with the Officer Personnel Record Review Board (OPRRB), requesting the invalidation of the five OERs in question. That Board denied his application in April 1970.

"In January 1970, plaintiff again failed to be selected for promotion. He submitted an application in June 1970, to the Air Force Board for the Correction of Military Records (AFBCMR). Again plaintiff's application was denied due to insufficient evidence to establish a showing of probable error or injustice. Although plaintiff requested a hearing, the Board, pursuant to AFR 31–3, denied the request and denied his application on June 22, 1971.

"Plaintiff sought legal relief through the United States District Court for the Northern District of Illinois in August 1971. After that court dismissed the complaint for lack of jurisdiction in January 1972, plaintiff appealed to the Seventh Circuit Court of Appeals, which affirmed the decision of the District Court on June 23, 1973. The Supreme Court denied a petition for writ of certiorari in December 1973. Plaintiff filed the instant action in this court on June 2, 1975.

"It is now well-established that this court will not review internal military personnel matters. Promotions are a matter of discretion with the military, and the courts are not in the promotion business. *Orloff* v. *Willoughby*, 345 U.S. 83 (1953); *Brenner* v. *United States*, 202 Ct. Cl. 678 (1973), *cert. denied*, 419 U.S. 831 (1974).

"Moreover, the plaintiff's claim has been denied by the Air Force Board for the Correction of Military Records. There is a substantial body of law to the effect that a court cannot overturn a decision of the BCMR unless it is affirmatively shown by cogent and clearly convincing evidence to be arbitrary, capricious, and not based upon substantial evidence, or is contrary to applicable law and regulations. Since there is a strong presumption that the Board and Secretary (who must approve the action of the Board) faithfully discharged their duties, plaintiff has the burden of proving otherwise. *See Cooper* v. *United States*, 203 Ct. Cl. 300, 304 (1973); *Dorl* v. *United States*, 200 Ct. Cl. 626, 633, *cert. denied*, 414 U.S. 1032 (1973), *Callan* v. *United States*, 196 Ct. Cl. 392, 450 F.2d 1121 (1971); *Biddle* v. *United States*, 186 Ct. Cl. 87 (1968). Plaintiff has not submitted cogent and clearly convincing evidence that the decision of the AFBCMR was

arbitrary or capricious. The vague and ambiguous conclusory statements offered by plaintiff do not qualify as such evidence.

"This court has also held that the action in refusing to grant a hearing is neither arbitrary nor contrary to law and that, in the absence of a clear showing that the Board acted arbitrary or capriciously, and therefore, unlawfully, its decision will not be disturbed. *See Boland* v. *United States*, 169 Ct. Cl. 145 (1965) and *Kurfess* v. *United States*, 169 Ct. Cl. 486 (1965).

"For the foregoing reasons, IT IS ORDERED that the defendant's cross-motion for summary judgment is granted, plaintiff's motion for summary judgment denied, and the plaintiff's petition is dismissed."

Plaintiff's motion for rehearing was denied January 7, 1977. On October 3, 1977 plaintiff's petition for certiorari was denied.

---

No. 345–75 NOVEMBER 12, 1976

World Instruction & Translation Co.

*Taxes; employment taxes; failure to pay employment taxes; penalty; suit to recover assessed penalties.*—On November 12, 1976 the court entered the following order:

*O. P. Easterwood, Jr.*, attorney of record for plaintiff. *McNutt, Dudley, Easterwood & Losch*, of counsel.

*Fenton P. Wilkinson*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Rose Anne Featherston*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case comes before the court on defendant's motion for partial summary judgment.

"For the period July 1, 1969, through December 31, 1973, plaintiff was assessed penalties for failure to deposit and failure to pay employers' withholding, Federal Insurance Contributions Act (FICA), and Federal Unemployment Tax

Act (FUTA) taxes. The defendant's motion is directed to the penalties assessed with respect to employers' withholding and FICA taxes for the last two quarters of 1969 and the first three quarters of 1970, for which taxpayer filed claims for refund on March 6, 1975.

"Under the provisions of the Internal Revenue Code, 26 U.S.C. §§ 7422 and 6511, plaintiff's claims for refund with respect to employers' withholding and FICA taxes for the last two quarters of 1969 and the first three quarters of 1970 were untimely. Since the claims for refund were not filed within the time required by law, the court concludes that it has no jurisdiction over plaintiff's suit for refund of the penalties paid with respect to those quarters. Therefore,

"IT IS ORDERED that defendant's motion for partial summary judgment on plaintiff's claim for refund of penalties paid with respect to employers' withholding and FICA taxes for the last two quarters of 1969 and the first three quarters of 1970 be and is hereby granted and that that part of the petition as to this claim is dismissed."

---

No. 24–76. NOVEMBER 12, 1976

Joseph W. Ryan, Jr.

*Civilian pay; annual leave accumulations; advance scheduling of excess leave; restoration of unused annual leave.*—On November 12, 1976 the court entered the following order:

*Joseph W. Ryan, Jr., Pro se.*

*Marc J. Fink*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case comes before the court on cross motions for summary judgment. There is no genuine issue as to any material fact.

"The controversy arises out of plaintiff's former employment as an Assistant U.S. Attorney for the Eastern District of New York. During his period of service, plaintiff had

earned over 96 hours of excess annual leave time but had forfeited his right to the leave because it had not been used prior to the close of 1974. Under 5 U.S.C. § 6304, plaintiff requested restoration of the forfeited annual leave upon the ground that the exigencies of public business prevented him from utilizing the leave. The request was denied by the Department of Justice upon the ground that plaintiff did not comply with a deadline date fixed by U.S. Civil Service Regulation, 5 C.F.R § 630.308, for scheduling annual leave during 1974. After seeking reconsideration from the Department of Justice, plaintiff sought administrative review first with the Civil Service Commission (CSC) and then with the General Accounting Office (GAO). Both the CSC and the GAO maintained that they could not grant an exception to the definition of "scheduled annual leave" because the requirement is statutory in origin, leaving no discretion with the agency to restore forfeited leave. As a result, plaintiff's appeals were denied.

"Plaintiff presently contends that the denial of restoration of annual leave was arbitrary, capricious and contrary to the spirit of 5 U.S.C. § 6304 and that the regulation does not prohibit the exercise by the agency of its discretion to permit restoration of forfeited annual leave.

"The legislative history of Pub. L. 93–181, which added the relevant part of 5 U.S.C. § 6304 now at issue, illustrates that Congress was aware of and interested in the scheduling of annual leave in advance requirement. The purpose of 5 U.S.C. § 6304(d)(1)(B) is not to penalize the employee who has previously planned for and scheduled a certain amount of annual leave and then is prevented from using it due to the exigencies of public business. However, the employee who does not pre-schedule his annual leave runs the risk of forfeiture.

"Section 6311 of title 5 gives the CSC the authority to prescribe regulations necessary for the administration of the subchapter. The CSC utilized this authority by implementing a regulation which stated that in order for restoration of annual leave to be considered, '* * * the decision to schedule annual leave for use shall be made in writing before the start of the third biweekly pay period prior to the end of the leave

year.' 5 C.F.R. § 630.308. This court has often said that '[w]hen a Government official or agency lawfully prescribes rules and procedures, these are binding on the Government as well as on its citizens.' *Whelan* v. *United States*, 208 Ct. Cl. 688, 694, 529 F. 2d 1000, 1003 (1976), and cases cited therein. Moreover, when an agency is given the responsibility of implementing a particular statute, as the CSC was given for the statute now at issue, this court shows great deference to the interpretation given the statute by the agency. *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Barrington Manor Apartments Corp.* v. *United States*, 198 Ct. Cl. 298, 304, 459 F. 2d 499, 502–503 (1972). The CSC regulation serves a useful and necessary purpose recognized by Congress for the administration of the leave program.

"Since the Department of Justice adequately informed plaintiff of the scheduling in advance requirement, since the plaintiff failed to schedule his annual leave sufficiently in advance as defined in 5 C.F.R. § 630.308, and since the denial of restoration of forfeited annual leave we do not find to be arbitrary or capricious,

"IT IS ORDERED that plaintiff's motion for summary judgment be and is hereby denied, that defendant's cross motion for summary judgment be and is hereby granted and that plaintiff's petition be and is hereby dismissed."

---

No. 127–76. NOVEMBER 12, 1976

Richard C. and Bonnie M. Craiglow

*Taxes; income tax; limitation on amount of credit or refund; prepaid income tax.*—On November 12, 1976 the court entered the following order:

*Donald H. Snell*, attorney of record for plaintiffs. *Kendrick, Kendrick & Bradley*, of counsel.

*Evelyn Leopold*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case is before the court on defendant's motion to dismiss plaintiffs' petition, and upon consideration thereof, together with the briefs of the parties, and without oral argument, the court concludes that the motion of defendant should be granted.

"The facts show that taxpayers filed, for the first time, their individual income tax returns for the calendar years 1970 and 1971 on June 17, 1975. The taxpayers' withholding taxes during those years exceeded their computed income tax liability, resulting in overpayments totaling $3,605. In their returns for 1970 and 1971, taxpayers requested that the overpayment in each year be credited to their tax liability for the succeeding tax year. The Internal Revenue Service refused to allow taxpayers' claims for credit and this suit followed.

"The applicable portions of the Internal Revenue Code are Sections 6511(b)(2) and 6513(b)(1). Section 6511(b)(2) limits the amount of allowable refund or credit to the portion of the tax paid three years prior to the date the claim is filed. The parties agree on the applicability of Section 6511(b)(2).

"The only point upon which the taxpayers and the Government disagree is the date the tax is deemed to have been paid. On this point, the language of Section 6513(d)(1) of the Code is clearly applicable. That section states in unequivocal terms that:

> (1) Any tax actually deducted and withheld at the source during any calendar year * * * shall, in respect to the recipient of the income, be deemed to have been paid by him on the 15th day of the fourth month following the close of his taxable year * * *.

According to this section, the taxes in question here are deemed paid on April 15 of the year following the close of the taxable years. Thus, the taxes withheld for the calendar year 1971 are deemed paid on April 15, 1972. As stated above, Section 6511(b)(2) limits the amount of allowable refund or credit to the portion of the tax paid during three years

prior to the filing of the claim, plus the period of any extensions of time for filing the return. Since there were no extensions of time, taxpayers' refund or credit is limited to the amount of tax paid during the three years prior to June 17, 1975, the date the claims were filed for 1970 and 1971. Since the taxpayers' income taxes for 1970 and 1971 were deemed to have been paid on April 15, 1971, and April 15, 1972, respectively, no amounts were paid during the limitation period and, therefore, the allowable credit or refund is zero. *See Domtar Newsprint Sales Ltd.* v. *United States*, 193 Ct. Cl. 505, 435 F. 2d 563 (1970).

"For these reasons, taxpayers have failed to state a claim upon which relief may be granted. Accordingly, defendant's motion to dismiss is granted and plaintiffs' petition is dismissed."

---

No. 179–76. NOVEMBER 12, 1976

William Williams, Jr.

*Civilian pay; Court of Claims jurisdiction; racial discrimination claim.*—On November 12, 1976 the court entered the following order:

*Benjamin L. Evans*, attorney of record for plaintiff.

*Vincent M. Garvey*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case is before the court on plaintiff's petition and defendant's motion to dismiss, and upon consideration thereof, and without oral argument, the court concludes that this is a racial discrimination suit by a black employee of the Bureau of Census, Social and Economic Statistics Administration (SESA) of the Department of Commerce, wherein the plaintiff alleges he would have been promoted to a grade higher than GS–9 but for such discrimination, and he sues for back pay. The court further concludes that under Section 717 of the Equal Employment Act of 1972 (42 U.S.C. § 2000e, *et seq*) and *Brown* v. *General Services Administra-*

*tion*, 425 U.S. 820 (1976), exclusive jurisdiction for this kind of a suit is vested in the U.S. District Courts, and, consequently, this court does not have jurisdiction of this case.

"We would transfer the case to the U.S. District Court, but for the fact that before filing suit here the plaintiff filed an identical suit in the D.C. District Court on July 18, 1975, in Civil Action No. 75–1157, which suit was dismissed by that court on November 12, 1975, for lack of subject matter jurisdiction because the suit was filed more than 30 days after final agency action denying relief became final on June 16, 1975, which failed to comply with the requirements of 42 U.S.C. § 2000e–16(c) for instituting such suits. Consequently, it would serve no purpose for us to transfer the case to the D.C. District Court.

"Defendant's motion to dismiss is granted and plaintiff's petition is dismissed."

---

No. 244–76. NOVEMBER 12, 1976

Holtzen Construction Company, Inc.

*Contracts; disputes; delay in performance; wage freeze; bad weather; reprocurement of a portion of the work; claim for recovery of assessed liquidated damages and lost profits.*— On November 12, 1976 the court entered the following order:

*Frank Carter*, attorney of record for plaintiff. *Carter, Carter & Richter*, of counsel.

*Stephen G. Anderson*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"Plaintiff, a Government contractor disappointed by the results of the Department of Agriculture Board of Contract Appeals (AGBCA), seeks our review of the Board's decision, to which the Wunderlich Act applies. On the basis of the plaintiff's original petition, the trial judge certified the case to us as one that involves only issues of law within Section 2 of the Act, 41 U.S.C. § 322. Plaintiff has recently taken notice of the Act, and by its amended petition now rephrases its attack

on the Board's decision in accordance with Wunderlich Act standards, and requests a trial. The Government had moved for summary judgment in response to plaintiff's original petition, but the motion is no less appropriate now because we can still treat the dispute as one that centers over several legal questions. We grant defendant's motion, and dismiss the petition.

"On February 25, 1972, the Department of Agriculture awarded plaintiff this construction contract originally scheduled for completion on September 14, 1972, but later extended by several equitable adjustments to March 30, 1973. Yet, plaintiff needed an additional 29 days to complete the work, on April 28, 1973, so the Department deducted $2,291 in liquidated damages from the plaintiff's contract payments. In addition, the Department deleted a portion of the work under the original contract, and reprocured that portion from another contractor. The Department then deducted from plaintiff's payments $6,300, the total costs of this work to the Government under the plaintiff's contract. Plaintiff sought to recover from the Board both the assessed liquidated damages, $2,291, and the profit it alleges that it would have earned except for the deletion and reprocurement, $4,410. The Board denied any relief, AGBCA No. 413, 75–2 BCA ¶ 11,378. Plaintiff now attacks the Board's conclusions as arbitrary, capricious and not entitled to finality.

"Plaintiff's first contention is that its delay in performance resulted from its inability to hire enough employees because the Government's delay of 8-months in approving a wage increase, apparently under the system of economic controls then in effect. Plaintiff submits that when it bid for the contract, it was relying on assurances of the Internal Revenue Service, the bureau then administering the economic controls, that a wage increase would be approved promptly. Plaintiff now complains that the AGBCA arbitrarily and capriciously ignored the IRS' promises of wage increase approval. When plaintiff previously presented its case to the Board, the Board responded that plaintiff failed to show that the 8-month wage freeze impaired its ability to complete the contract on time. Rather, the Board's comparison of plaintiff's work diaries indicates that plaintif utilized substan-

tially the same number of employees during and after the wage freeze. Since the results of this comparison are uncontroverted, they furnish substantial evidence for the Board's conclusion that plaintiff's reliance on IRS' assurances of an early thaw of the wage freeze was immaterial to its delayed contract performance.

"Plaintiff next complains that the Board arbitrarily denied plaintiff's claim that there were 29 days of 'bad weather' during the performance period, which would justify its delay and relieve it of 29 days of liquidated damages. If inclement weather is plaintiff's escape from liquidated damages assessed under Clause 5(c) of the contract, it must be weather that met the description contained in Clause 5(d)(1): 'unusually severe weather'. That language implies a comparison of the weather that occurred during contract performance with what may be considered typical weather for that season. But plaintiff does not now allege that the weather, albeit inclement, was any worse than that usually endured during winter and spring. And even though the AGBCA treated plaintiff's contention as an allegation of 'abnormally bad weather', 75–2 BCA at 54,158, it rejected this point because plaintiff failed to present supporting evidence. Plaintiff has not done so yet, inasmuch as its statement that the relevant facts were a matter of common knowledge are legally insufficient, especially in view of our role in Wunderlich Act cases. So, again, we affirm the Board's result.

"Plaintiff's last claim is to recover the profit it would have earned if it were permitted to perform the portion of the work that the Department deleted and reprocured. The Board was clearly correct in denying relief, thereby implementing the principle that an equitable adjustment such as the Board could make under the contract for a change eliminating items of work does not include anticipatory profits for work not done. *General Builders Supply Co.* v. *United States*, 187 Ct. Cl. 477, 409 F. 2d 246 (1969). This is equally true, whether work is deleted under the 'Changes' or 'Termination for the Convenience of the Government' clauses.

"Accordingly, upon consideration of the pleadings, defendant's motion to dismiss and petitioner's opposition thereto, and the briefs and representations of the parties but

without oral argument, it is ORDERED that the motion to dismiss be granted and the plaintiff's petition is dismissed."

---

No. 309–72. NOVEMBER 19, 1976

Coastal Petroleum Company

*Pleading and practice; third-party practice; notice.*—On November 19, 1976 the court entered the following order:

"There came on for consideration, defendant's motion for leave to file out of time, its motion for notice to a third party under Rule 41(a)(1). Defendant's motion, filed November 16, 1976, is accompanied by one document entitled 'Defendant's Motion for Notice of Claim to Third Party' and another document entitled 'Third-Party Notice of Claim.'

"After a review of these papers, I find that defendant's motion for leave to file out of time should be granted, but its 'Motion for Notice of Claim to Third Party' is hereby denied, because the notice and the accompanying 'Third-Party Notice of Claim' contain indications that defendant has filed in this court a contingent claim for recovery of money against the third party, and may mislead the third party into the belief that the court has issued a summons on motion of the United States pursuant to Rule 41(a)(2).

"IT IS THEREFORE ORDERED that defendant is hereby granted leave to file within 10 days from this date, a proper motion for notice to the third party under Rule 41(a)(1). [Motion filed November 29, 1976.] The motion shall omit in the heading the phrase 'of claim' and a statement such as that contained in the second sentence, which may leave the impression that defendant has filed in this court a contingent claim for the recovery of money against the third party. If the motion is accompanied by a document similar to the 'Third-Party Notice of Claim' filed with the motion of November 16, 1976, the words 'of claim' shall be omitted from the heading and the words 'of its claim' in the second line shall likewise be omitted, but the notice may contain all of the other statements set forth in the 'Third-Party Notice of Claim.' *See Bowser, Inc.* v. *United States*, 190 Ct. Cl. 441, 420 F. 2d 1057 (1970)."

WILSON COWEN,
*Chief Judge.*

Nos. 54–75 and 394–76. NOVEMBER 19, 1976

Albert W. Morton

*Civilian pay; racial discrimination claim; transfer of cases to district court.*—On November 19, 1976 the court entered orders in the above entitled cases as follows:

*Albert W. Morton, Pro se.*

*Vincent M. Garvey*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, Judge, Presiding, NICHOLS and KASHIWA, *Judges.*

"In this case [No. 394–76] the plaintiff, a black employee of H.E.W., sues to recover money damages for alleged racial discrimination against him during his employment and also to recover money damages for libel and slander against him by officials of H.E.W. The case comes before the court on plaintiff's motion to transfer the case to the United States District Court for the Northern District of Georgia and defendant's motion to dismiss or, in the alternative, to transfer the case to an appropriate district court.

"Upon consideration thereof, the court concludes that in view of the decisions of the Supreme Court in *United States* v. *Testan*, 424 U.S. 392 (1976) and *Brown* v. *General Services Administration*, 425 U.S. 820 (1976), it has no jurisdiction of plaintiff's claim for damages due to racial discrimination and that the case should be transferred to an appropriate district court pursuant to the Equal Employment Opportunity Act of 1972 and 28 U.S.C. § 1506.

"The court concludes further that as to the plaintiff's claim for damages for libel and slander, the court has no jurisdiction of the same because it sounds in tort. *See* 28 U.S.C. § 1491.

"IT IS THEREFORE ORDERED that defendant's motion to dismiss is denied and plaintiff's and defendant's motions to transfer the case to an appropriate district court are granted, and the case is hereby transferred to the United States District Court for the Northern District of Georgia."

The petition of Albert W. Morton in case No. 54–75 seeking money damages for alleged racial discrimination against him

during his employment at H.E.W. has also been transferred to the United States District Court for the Northern District of Georgia pursuant to an order of the court entered November 19, 1976.

---

No. 63–75. NOVEMBER 19, 1976

Bernard I. Shovlin

*Regional Rail Reorganization Act; redress of holders of bonds.*—On November 19, 1976 the court entered the following order:

*Edwin J. McDermott*, attorney of record, for plaintiff.

*John Broadley*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges.*

"The case again [1] comes before the court, this time on cross-motions for summary judgment. Defendant asks, in the alternative, that the case be stayed indefinitely.

"What plaintiff seeks is less clear. The merits concern the rights of holders of bonds issued by Morris and Essex Railroad Company and secured by a first lien on the property of the Erie-Lackawanna Railroad Company (Erie) to immediate redress in this court for alleged Fifth Amendment takings. The Erie is presently in reorganization and subject to the Regional Rail Reorganization Act of 1973 (Rail Act), 45 U.S.C. § 701 *et seq.*, *as amended by* Railroad Revitalization and Regulatory Reform Act of 1976 (RRRRA), P.L. 94–210 (Feb. 5, 1976).

"Plaintiff-bondholder originally sought compensation, in the form of payment of the face amount of bonds plus interest, for both forced conveyance of Erie assets to ConRail and erosion of these assets because of continued forced deficit operations. In his final brief, however, plaintiff seems to have given up claim to the erosion taking and concentrates instead on the conveyance taking.

---

[1] On March 12, 1976, the court denied plaintiff's request for prompt review of a trial judge's order. Order of March 12, 1976. Ct. Cl. No. 63–75.

"Considering the parties' motions, the court holds that defendant's motion requesting an indefinite stay should be granted and plaintiff's motion denied. The primary reasons for a stay are judicial economy and the fact that this entire action is premature. The intent of Congress, expressed in the Rail Act, the RRRRA, and elaborated upon in the Report of the Committee of Conference on S. 2718 (the RRRRA), S. Rep. No. 94–595, 94th Cong., 2d Sess. (1976), is that actions such as this one in the Court of Claims should be stayed 'until the Special Court has ordered the distribution of the securities and the certificates of value and compensation' pursuant to the Act. S. Rep. No. 94–595, *supra* at 205–06. It remains to be considered at a later date whether plaintiff, if he in fact has a cause of action separate from that of the Trustees in Bankruptcy of Erie, will be due compensation over and above that granted to the railroad company by the Special Court.

"IT IS THEREFORE ORDERED, upon consideration of the briefs and without oral argument, that plaintiff's and defendant's motions for summary judgment are denied. Defendant's alternative motion for an indefinite stay of proceedings is granted.

"IT IS FURTHER ORDERED that, six months from the date of this order, plaintiff's attorney inform the court by letter to the Clerk of the status of proceedings before the Special Court concerning the Erie-Lackawanna Railroad Company."

On February 4, 1977 the court denied plaintiff's suggestion for rehearing *en banc* and motion for rehearing.

---

No. 100–75. NOVEMBER 19, 1976

David P. Trainer

*Regional Rail Reorganization Act; redress of holders of bonds.*—On November 19, 1976 the court entered the following order:

*Edwin J. McDermott*, attorney of record, for plaintiff.

*John Broadley*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges*.

"The case again [1] comes before the court, this time on cross-motions for summary judgment, on plaintiff's motion to strike defendant's motion for summary judgment, and defendant's opposition thereto. Defendant asks, in the alternative, that the case be stayed indefinitely.

"What plaintiff seeks is less clear. The merits concern the rights of holders of bonds issued by the Pittsburgh, Cincinnati, Chicago & St. Louis Railroad Company (later merged into the Philadelphia, Baltimore & Washington Railroad Company (PBWRR)), to immediate redress in this court for alleged Fifth Amendment takings. The PBWRR is presently in reorganization and subject to the Regional Rail Reorganization Act of 1973 (Rail Act), 45 U.S.C. § 701 *et seq.*, *as amended by* Railroad Revitalization and Regulatory Reform Act of 1976 (RRRRA), P.L. 94–210 (Feb. 5, 1976).

"On the merits, plaintiff-bondholder originally sought compensation, in the form of payment of the face amount of bonds plus interest, for both forced conveyance of PBWRR assets to ConRail and erosion of these assets because of continued forced deficit operations. The assets of PBWRR secure the bonds. In his final brief, however, plaintiff seems to have given up claim to the erosion taking and concentrates instead on the conveyance taking. Procedurally, plaintiff requests this court strike defendant's motion for summary judgment on the ground that it fails to comply with Ct. Cl. Rule 101(d).

"Addressing the procedural bar plaintiff raises against defendant's motion for summary judgment, the court denies plaintiff's motion. Not only does plaintiff misconstrue Rule 101(d), but to hold otherwise would run counter to Rule 1 of this court, that the rules are to be interpreted 'to promote the just, speedy, and inexpensive determination of every action.'

"We now turn to the parties' cross-motions for summary judgment.

"The court holds that defendant's motion requesting an indefinite stay should be granted and plaintiff's motion

[1] On Feb. 13, 1976, the court denied plaintiff's request for prompt review of a trial judge's order. Order of Feb. 13, 1976. Ct. Cl. No. 100–75.

denied. The primary reasons for a stay are judicial economy and the fact that this entire action is premature. The intent of Congress, expressed in the Rail Act, the RRRRA, and elaborated upon in the Report of the Committee of Conference on S. 2718 (the RRRRA), S. Rep. No. 94–595, 94th Cong., 2d Sess. (1976), is that actions such as this one in the Court of Claims should be stayed "until the Special Court has ordered the distribution of the securities and the certificates of value and compensation" pursuant to the Act. S. Rep. No. 94–595, *supra* at 205–06. It remains to be considered at a later date whether plaintiff, if he in fact has a cause of action separate from that of the Trustees in Bankruptcy of PBWRR, will be due compensation over and above that granted to the railroad company by the Special Court.

"IT IS THEREFORE ORDERED, upon consideration of the briefs and without oral argument, that plaintiff's and defendant's motions for summary judgment are denied, and plaintiff's further motion to strike defendant's motion for summary judgment is denied. Defendant's alternative motion for an indefinite stay of proceedings is granted.

"IT IS FURTHER ORDERED that, six months from the date of this order, plaintiff's attorney inform the court by letter to the Clerk of the status of proceedings before the Special Court concerning PBWRR."

No. 441–75. NOVEMBER 19, 1976

Rudolph Powers

*Military pay; limitation of actions; veterans benefits; Court of Claims jurisdiction to review decisions of Veterans Administration.*—On November 19, 1976 the court entered the following order:

*Rudolph Powers, pro se.*

*Arlene Fine*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges*.

"This case is before the court on plaintiff's motion for summary judgment and defendant's cross-motion for summary

judgment. Plaintiff, who served in the United States Navy in 1951, was given an undesirable discharge and total forfeitures after about a year of his 4-year enlistment because of his conviction for robbery in a New York court. After several years of imprisonment his conviction was overturned. In 1965 the Navy corrected his discharge to an honorable one and gave him mustering-out pay. The Board for Correction of Naval Records (BCNR) considered plaintiff's claim for restoration to duty and back pay. The board denied the same, concluding that plaintiff had not performed active duty for which pay was claimed and that his imprisonment was not the fault of the Navy. However, the BCNR determined that, because of plaintiff's mental disability which was held to have been service-incurred, he should retroactively be placed on the Temporary Disability Retired list, effective May 17, 1952 (the day after his undesirable discharge), and on the Retired list, by reason of permanent disability, as of May 17, 1957. Retired pay was offset against benefits plaintiff received from the Veterans Administration, and plaintiff was paid $11,650.64.

"In suit filed in this court on July 9, 1971, plaintiff claimed entitlement to active duty pay and allowances for the balance of the term of his enlistment following the date of his arrest, October 9, 1951, plus entitlement to disability retired pay. The court denied relief on the grounds that plaintiff, not having been under any legal disability since his release from state prison on September 30, 1963, was barred by the 6-year statute of limitations. *Powers* v. *United States*, 198 Ct. Cl. 995 (1972).

"In the pending petition plaintiff claims back pay and allowances for the period October 9, 1951, to the date of his undesirable discharge on May 16, 1952. This period is clearly included in the period for which judgment for plaintiff was denied by the court, as aforesaid. The present claim is thus barred by *res judicata* unless, as plaintiff argues, the correction board action in 1973 tolled the statute of limitations. It did not do so. The court concluded in its 1972 decision that plaintiff could have brought suit in 1963. The appeal to the board was a permissive remedy. At the latest plaintiff could have sued in 1965 when his discharge was corrected.

"Plaintiff also sues for the right to waive his retired pay in favor of benefits from the Veterans Administration which are alleged to be greater in his case. When plaintiff's discharge was corrected by the Navy on April 2, 1965, the VA reopened plaintiff's claim and awarded him benefits retroactive to November 29, 1964. It is precluded by statute from now awarding benefits claimed for the 1952–64 period. 38 U.S.C. § 3010(i) (1970). Further, the actions of the Veterans Administration in administering the statute providing for veterans' benefits are insulated from judicial review. 38 U.S.C. § 211(a) (1970). *Johnson* v. *Robinson*, 415 U.S. 361 (1974); *Martin* v. *United States*, 197 Ct. Cl. 1062 (1972); *Jump* v. *United States*, 164 Ct. Cl. 453 (1964); *Brown* v. *United States*, 150 Ct. Cl. 836 (1960). Plaintiff has not stated a claim for which relief can be granted. We find nothing unconstitutional here.

"Upon a careful examination of the pleadings, the motions, and the BCNR records filed with the court, without oral argument, we conclude that the board acted lawfully and with a proper exercise of its discretion in awarding plaintiff disability retired pay and in not granting him active duty pay and allowances and that this court has no authority to review the actions of the Administrator of Veterans Affairs within the context of this claim.

"Collateral motions of the parties for discovery of BCNR documents are moot by reason of their production.

"IT IS THEREFORE ORDERED that defendant's cross-motion for summary judgment be and it is granted. Plaintiff's motion for summary judgment is denied. The petition is dismissed."

---

No. 265–76. NOVEMBER 19, 1976

Richmond A. Ware

*Military pay.*—On November 19, 1976 the court entered the following order:

*Richmond A. Ware, pro se.*

*LeRoy Southmayd, Jr.*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges*.

"This military pay case comes before the court on defendant's motion to dismiss filed September 7, 1976.

"Plaintiff was commissioned a second lieutenant in the Army Signal Corps in May 1942 and separated from active duty in December 1945. He was retired as a Major in the United States Air Force Reserve as of July 1, 1970, and alleges that he will be eligible to receive retirement pay as of June 4, 1980. Plaintiff also alleges that during the period between September 1962 and July 1970, he received Officer Effectiveness Reports (OERs) prepared by an officer junior to him in grade and rank, which OERs were libelous, maliciously untrue and prepared with intent to defame plaintiff's duty performance, his character and personal appearance; that as a result of these OERs he was not promoted to lieutenant colonel in March 1969; that the OERs were removed from his file by order of the Secretary of the Air Force, but that he was again denied promotion in 1970 because there were no OERs in his file for his last 2 years of satisfactory service in the Air Force Reserve. Plaintiff seeks judgment for damages in the amount of $250,000.

"Defendant has moved to dismiss the petition on several grounds, and while plaintiff's petition is understandably deficient because he is a layman attempting to represent himself, plaintiff has filed a response in which he has attempted to persuade the court to deny defendant's motion to dismiss. In its motion, defendant first argues that plaintiff's claim for damages on the ground of allegedly malicious and libelous OERs is a claim sounding in tort, upon which no relief can be granted. This contention is plainly correct, and in his response, plaintiff now disclaims any right to recover for tortious actions.

"Citing *United States* v. *Testan*, 424 U.S. 392 (1976), the defendant next argues that since plaintiff will not be eligible to receive any retirement pay in his retired grade of major until May 1980, his petition must be dismissed because he has no claim for 'actual, presently due money damages from the

United States.' In his response plaintiff counters with the allegation that had he not been retired in 1970, he would have earned active duty pay on active duty tours over a period of about 6 years prior to the filing of his petition. He also asserts that if he recovers, he will be entitled to the retirement pay of a colonel, discounted at the present value. This latter contention must be rejected, but the court feels that plaintiff should be given an opportunity to amend his petition to assert a claim for the amount he would have received for active duty tours between 1970 and 1976.

"The third ground on which defendant's motion is based is that plaintiff's claim is barred by the equitable doctrine of laches. In his response, plaintiff apparently contends that laches should not apply because of assurances he received from Air Force officers that laches would not apply to his claim until 6 years after his retirement. This contention should be supported by more complete allegations in a petition.

"In view of the foregoing, IT IS ORDERED that plaintiff shall have 45 days from this date within which to file an amended petition in which he shall set forth more specifically his claim with respect to the following:

"(1) Whether with respect to the two sets of OERs there was a violation of any valid regulation or published procedure of the Air Force, and if so, a reference to the particular regulation and a statement of the manner in which it was allegedly violated;

"(2) a statement of the approximate amount per year plaintiff would have been paid through active duty tours had he not been retired and remained on duty from 1970 to 1976, and

"(3) a detailed statement of the representations plaintiff relies on to defeat the defense of laches, including a chronological statement of the events relied upon and the names and official positions of the persons making the representations.

"IT IS FURTHER ORDERED that defendant's motion to dismiss is denied without prejudice to its right to renewal of the motion if it elects to do so after the filing of plaintiff's amended petition, instead of filing an answer."

No. 297–76. NOVEMBER 19, 1976

George Dwain Hurst

*Court of Claims jurisdiction; racial discrimination claim; injunctive or declaratory relief.*—On November 19, 1976 the court entered the following order:

*George D. Hurst, pro se.*

*Alan L. Ferber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges.*

"We have before us, without oral argument, defendant's motion to dismiss plaintiff's petition, which describes itself a 'civil rights complaint and claim against the United States of America.'

"Relying on 42 U.S.C. §§ 1981, 1983 and 1986, plaintiff alleges that his rights under the Fourteenth Amendment of the Constitution have been violated in that the United States District Court for the District of Wyoming has not issued final orders or taken any other action on a mandate issued by the United States Court of Appeals for the Tenth Circuit, relating to plaintiff's civil rights actions.

"Plaintiff's petition does not state any cause of action which can be entertained by the Court of Claims under the Tucker Act, 28 U.S.C. § 1491, and the sections of the Code to which plaintiff refers all pertain to suits in the United States District Courts.

"It is therefore clear that since this court has no jurisdiction of plaintiff's suit, his petition must be dismissed. *See Brown* v. *General Services Administration*, 425 U.S. 820 (1976), and *King* v. *United States*, 395 U.S. 1 (1968).

"IT IS THEREFORE ORDERED that defendant's motion to dismiss plaintiff's petition is granted."

---

No. 389–75. NOVEMBER 26, 1976

Inland Steel Company

*Taxes; income tax; deductions; expenses, trade or business; taxable year of deduction; "all events" test; accrual*

*basis taxpayer.*—On November 26, 1976 the court entered the following order:

*Frederic W. Hickman* for plaintiff; *Charles W. Davis*, attorney of record. *Hopkins, Sutter, Mulroy, Davis & Cromartie*, of counsel.

*Robert S. Watkins*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

---

Before SKELTON, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges.*

"This case for the recovery of taxes under 26 U.S.C. § 7422(a), Internal Revenue Code, comes before the court on cross motions for summary judgment. There is no genuine issue as to any material fact.

"The sole issue in this case is whether plaintiff, reporting on the accrual basis, is entitled under the 'all events' test of Section 461 of the Internal Revenue Code of 1954 (Code) and Treasury Regulations thereunder to deduct when credited the amounts it became obligated to pay pursuant to the steel industry's union-management negotiated 1962 Supplemental Unemployment Benefit (SUB) Plan, where plaintiff's liability for such amounts was fixed and absolute but the time of payment was uncertain.

"Exactly the same legal question involving the same liability under the same SUB plan was resolved in favor of other steel companies in *Lukens Steel Co.* v. *Commissioner*, 442 F. 2d 1131 (3d Cir. 1971), *aff'g* 52 T. C. 764 (1969), and *Cyclops Corp.* v. *United States*, 408 F. Supp. 1287 (W.D. Pa. 1976). The decision of the court in each of the above cases relies on the opinion of this court in *Washington Post Co.* v. *United States*, 186 Ct. Cl. 528, 405 F. 2d 1279 (1969), which rests, in turn, on a long line of precedent.

"Defendant acknowledges that obligations similar to those here in issue were considered and allowed as deductions in *Lukens* and *Cyclops* but argues that *Lukens* was wrongly decided. See, also, Rev. Rul. 72–34, 1972–1 Cum. Bull. 132. It also seeks to distinguish the instant case from *Washington Post.*

"There is no issue here concerning the governing law. Instead, the only issue concerns the application of the law to the facts of this case, i.e., whether, as plaintiff contends, all events occurred in 1962 and 1963 to fix absolutely plaintiff's obligation to pay the SUB plan 'contingent liability,' or whether, as the defendant contends, plaintiff's liability to pay the SUB plan 'contingent liability' depended upon the occurrence of future events which must be considered conditions precedent to a proper accrual under the 'all events' test.

"We find that under the 1962 SUB plan, the obligation of the plaintiff steel company to pay the amounts accrued by it as 'contingent liability' became fixed and absolute and determinable in amount when accrued. As hourly services were rendered by employees during the taxable year, the plaintiff became, on a monthly basis, irrevocably committed to ultimately pay the prescribed amounts of 'contingent liability' produced by such hours worked. Although the term 'contingent liability' was used to describe the amounts in issue, the liability to pay such amounts was not contingent. No further event was required to establish this liability and no event other than payment or bankruptcy—not even termination of company operations—could relieve plaintiff of its obligation. The only uncertainty involved was as to the timing of the payment.

"Section 461(a) of the Code provides the general rule for determining the taxable year in which an expense is allowable as a deduction. Plaintiff computes its taxable income under the accrual method of accounting and, accordingly, the taxable year in which its expenses are deductible is determined under the 'all events' test set forth in Treas. Reg. § 1.461–(1)(a)(2). Consistent with the regulation and the concept of accrual accounting, uncertainty as to the time of payment is irrelevant once the fact and the amount of the liability are established. *Lukens, supra; Washington Post, supra;* and the cases cited therein.

"The legal issue presented here has already been decided against the defendant in the *Lukens* and *Cyclops* cases, which, as stated, involved the same collective bargaining agreement, the same SUB plan, the same items of 'contin-

gent liability,' and the same taxable years as are involved here. Under these circumstances,

"IT IS ORDERED that defendant's cross motion for summary judgment be and is hereby denied, that plaintiff's motion for summary judgment be and is hereby granted, and that the amount of any recovery of the claimed overpayment of federal income taxes for the taxable years 1962 and 1963, plus statutory interest as provided by law, be determined under Rule 131(c)."

On May 6, 1977 the court entered judgment for plaintiff to recover for calendar year 1962 federal income taxes in the amount of $1,280,283, penalties in the amount of $7,694, plus assessed interest in the amount of $374,649, together with statutory interest as provided by law, and for calendar year 1963 federal income taxes in the amount of $212,875, plus assessed interest in the amount of $70,581, together with statutory interest as provided by law.

---

No. 165–76. NOVEMBER 26, 1976

Lena Rosa K. Conley

*Judgments; former adjudication; res judicata and collateral estoppel.*—On November 26, 1976 the court entered the following order:

*Lena Rosa K. Conley, pro se.*

*Susan M. Linden*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

"On September 10, 1976, the court entered its order suspending further proceedings in this case until thirty days after the disposition by the United States Court of Appeals for the Fourth Circuit of both *Conley* v. *Hampton*, No. 75–1673, and *Conley* v. *Berzak*, 75–1826. On October 6, 1976, defendant informed the court that the Fourth Circuit had, on July 28, 1976, affirmed in a joint opinion the judgments in those two cases adverse to plaintiff. At the same time defendant renewed its request that the petition in this court be dis-

missed. Plaintiff has filed no response to this supplemental memorandum, and her time for so filing has elapsed.

"The Fourth Circuit held that plaintiff had failed to timely file an appeal with the Civil Service Commission with respect to her claim that her resignation had been coerced and was involuntary, and therefore that she had failed to exhaust her administrative remedies. This determination is binding on us under the principles of *res judicata* and collateral estoppel, and disposes of the case before us which seeks back pay and reinstatement based on the same claim of a coerced resignation.

"IT IS THEREFORE ORDERED AND CONCLUDED that the suspension of further proceedings in this case is lifted, the defendant's motion to dismiss the petition is granted, and the petition is dismissed on the ground that the claim is precluded, under the doctrines of *res judicata* and collateral estoppel, by the decision of the Fourth Circuit that plaintiff failed to exhaust her administrative remedy."

---

No. 317–71. DECEMBER 3, 1976

Russell J. Abbott, et al.

*Civilian pay; overtime and holiday pay; stipulation of facts; unresolved factual issues; remand to trial division.*—On December 3, 1976 the court entered the following order:

*Thomas M. Gittings, Jr.*, attorney of record, for plaintiffs.

*LeRoy Southmayd, Jr.*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before NICHOLS, *Judge*, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This case is before the court on the Trial Judge's Memorandum Report returning the case to the court pursuant to Rule 134(b). Plaintiffs are Air Safety Investigators employed by the Bureau of Safety of the Civil Aeronautics Board and the successor to its functions, the National Transportation Safety Board. These investigators are responsible

for the investigation of accidents and incidents in the operation of aircraft. Each investigator is under orders to travel to the investigation site by the quickest means available.

"Plaintiffs' claims for compensation involve two major categories of issues. First, whether plaintiffs are entitled to overtime compensation and holiday pay for travel undertaken in the cockpit of an aircraft on a jump seat in an 'Access to Aircraft' capacity? Second, whether plaintiffs are entitled to overtime compensation and holiday pay for travel time spent as passengers on commercial aircraft or aboard other modes of transportation to and from investigation sites? The parties submitted a Stipulation of Facts, stating that it contained all the relevant facts pertaining to liability issues, in order that this controversy could be adjudicated pursuant to Rule 134(b). However, from the briefs and oral argument, it is evident that certain factual issues were not stipulated and are still in dispute, so that the stipulation is therefore inadequate. These factual issues must be resolved through further stipulation or trial before the case can ultimately be determined by this court. Examples of unresolved factual issues in this case include the following.

"A factual dispute between the parties has arisen subsequent to the enactment of the stipulation, concerning the authenticity of the alleged Attachment B to Bureau of Safety Memorandum 65–41. Defendant contends that no plaintiff presented any timely proof to the agency that he had accumulated time for which he would be entitled to overtime compensation, during the period in issue, for travel in an Access to Aircraft capacity. Defendant also submits that plaintiffs have made no showing that the requisite reports concerning Access to Aircraft travel were filed. Plaintiffs explain that Attachment B establishes the proposition that defendant would not have even considered plaintiffs as eligible for overtime compensation for travel time spent in an Access to Aircraft capacity, thus excusing their failure to claim overtime. Defendant attacks the authenticity of Attachment B, primarily through the letter of Mr. Froman. In light of the importance of this matter to the controversy, the authenticity of Attachment B, a factual issue not covered by the stipulation, must be resolved, unless shown to be irrelevant.

"Concerning the claims for travel as a passenger on commercial aircraft, the stipulation provides very little factual information as to how much work the investigators actually did, or needed to do, while traveling. For instance, Paragraph No. 14 of the stipulation states that an investigator, traveling alone, 'in many instances * * * is engaged in planning the investigation'. However, this same paragraph also states that 'part of the travel period may be spent resting.' This gives the court insufficient facts as to the intensity and frequency of such work on which to base a determination that travel as a commercial air passenger towards a disaster site is to be regarded as a working or 'on duty' period.

"Information must be established to determine whether plaintiffs' claims are properly joined together in one suit, or if these claims should be treated individually. Relevant factors include the percentage of real disasters investigated versus incidents of a minor nature, and the relative number of investigators operating out of Washington, as opposed to field offices closer to investigation sites, but dealing with less urgent matters.

"An additional area of ambiguity concerns whether the record and findings of fact in *Griggs* v. *United States*, Ct. Cl. No. 336–65 (1967) should apply to the instant case. In *Griggs*, the decision of Commissioner (now Judge) Maletz was accepted by the parties involved without a decision by this court. Presumably, the parties disposed of the case in this manner for the very purpose of avoiding a judgment that would have res judicata, collateral estoppel, or even stare decisis effect. It is unclear to what extent the parties to the instant case, in the stipulation, intend to undo this result. Through Paragraph No. 4 of the stipulation, plaintiffs reserved the right to seek a redetermination of the *Griggs* holding that the investigators are not entitled to overtime compensation for travel as passengers on commercial aircraft because they were not required to perform any work while traveling. However, Finding of Fact No. 34 in *Griggs* determined that, while that plaintiff was traveling on commercial aircraft, he was not required to perform any work, and traveled as would any passenger on a commercial flight. A clear expression of the parties' intent as to the applicability

of *Griggs* would aid the court in a determination of the case at hand. For example, are the facts found in *Griggs* intended to be stipulated into this case? Is the evidence before the Trial Judge? Is the recommended decision to be regarded as a holding of this court, except to the extent specified in Paragraph No. 4? The parties are reminded that stipulations of law do not bind the court.

"IT IS THEREFORE ORDERED that the case be remanded to the Trial Division for further proceedings consistent with this Order."

---

No. 6–76. DECEMBER 6, 1976

SCM Corporation

*Contracts; disputes; administrative remedies; failure to exhaust; delay in processing claim.*—On December 6, 1976 the court entered the following order:

*Louis W. Brydges*, attorney of record, for plaintiff.

*Arlene Fine*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This case is before the court on defendant's motion to dismiss, plaintiff's cross-motion for summary judgment, and defendant's motion for suspension of proceedings on plaintiff's cross-motion for summary judgment. Plaintiff contracted with defendant for the manufacture of equipment. Under the contract, plaintiff was to be paid upon completion of Phase I of the contract, and in accordance with an incentive price revision clause. After completion of Phase I, plaintiff forwarded to defendant a contract pricing proposal. Government auditors came to plaintiff's plant for a price audit on August 4, 1975. Prior to proceeding with the audit, the auditors were informed that plaintiff would not permit them to remove certain proprietary information from the plant. The auditors left the plant, refusing to conduct the audit under such conditions. Plaintiff sent defendant an invoice for final payment and demanded a final decision on the

claim by the contracting officer. On September 22, 1975, the contracting officer informed plaintiff that, since the auditors were not able to conduct the audit under plaintiff's restrictions, the problem had not reached the point of a "dispute," and he could make no final decision at that time on the amount of the claim. Subsequent negotiations between the parties ensued. Plaintiff filed suit in this court on January 8, 1976. The contracting officer issued a final decision, denying payment of the amount claimed for lack of a meaningful audit, on January 21, 1976. Plaintiff appealed this decision of the contracting officer to the Armed Services Board of Contract Appeals (ASBCA) on February 17, 1976.

"The issue in this case is whether the delay by the contracting officer was so unreasonable as to relieve plaintiff of the obligation to exhaust administrative remedies. The standard to be followed involving the reasonableness of a contracting officer's delay was set out in *Sun Shipbuilding & Dry Dock Co.* v. *United States*, 198 Ct. Cl. 693, 702–03, 461 F. 2d 1352, 1358, *cert. denied*, 409 U.S. 1023 (1972):

> There is, of course, no rule of thumb for appraising delays in the contractual-administrative process. Like all tribunals, the procuring agency has considerable discretion and leeway in controlling its procedure, and must have due time to decide fairly. On the other hand, it cannot abuse its discretion by dragging its feet so leadenly that the delay becomes intolerable. The overall standard for evaluating the propriety of a delay looks to the particular case and the particular situation: the agency "cannot wait indefinitely before making a decision, but must act within a reasonable time under the existing facts and circumstances."

If the delay is reasonable, plaintiff should be required to exhaust available administrative remedies. If the delay is unreasonable, plaintiff's claim may be cognizable in this court in a breach of contract action. *Universal Ecsco Corp.* v. *United States*, 181 Ct. Cl. 10, 17–18, 385 F. 2d 421, 425–26 (1967).

"Weighing all the facts and circumstances of this case, we conclude that plaintiff should be required to exhaust its administrative remedies before the ASBCA before proceeding with its claim in this court. Several factors distinguish this case from situations, such as *Universal Ecsco Corp.*,

where the court has not required a plaintiff to first exhaust administrative remedies due to unreasonable delay by the Government. The time period between the onset of the controversy on August 4, 1975 and the filing of suit in this court on January 8, 1976 was only five months. The continued negotiations between the parties during this period left defendant with a reasonable expectation that a settlement could be reached by the parties without resorting to litigation. Plaintiff's interests can be legitimately protected by first proceeding through the ASBCA. This court will be available for plaintiff to seek review of any adverse decision by the ASBCA, if such a step becomes necessary.

"The proper procedure to follow where an appeal has actually been filed with the ASBCA is to stay further proceedings in this court and remand the case to the ASBCA. *RFI Shield-Rooms* v. *United States*, 206 Ct. Cl. 848, 849 (1975).

"IT IS THEREFORE ORDERED that the case is remanded, pursuant to Rule 149, to the ASBCA for further proceedings under the contract. Further proceedings before this court are stayed for a period of six (6) months from the date of this Order. Plaintiff's counsel is designated to advise the court by letter to the trial judge of the status of the remand proceedings pursuant to Rule 149(f). Attention of counsel and the ASBCA is also directed to Rule 150. Defendant's motion to dismiss without prejudice, plaintiff's cross-motion for summary judgment, and defendant's motion for suspension of proceedings on plaintiff's cross-motion for summary judgment are denied."

---

No. 195–72. JANUARY 5, 1977

Joseph E. Bennett Co.

*Contracts; changed conditions; subsurface conditions differing from indications in contract; acceleration of performance.*—Plaintiff seeks review under Wunderlich Act standards of adverse portions of decisions of two panels of the General Services Administration Board of Contract Appeals with respect to contract for construction of a one-story Internal Revenue Service building and appurtenances. The first

panel ruled that the actual soil encountered was not sufficiently different from that represented in the contract specification to constitute a changed condition entitling plaintiff to added compensation, but that having to cope with unexpected subsurface ground water was. The second panel ruled that the contracting officer's directive to complete the contract by the original contract date was not an acceleration order because plaintiff was then already substantially behind schedule and had not made an adequate showing that the contract modifications required the extensions requested; the panel also found, *inter alia*, that plaintiff's acceleration efforts were only sufficient to offset its own delays. On August 21, 1975 Trial Judge Philip R. Miller filed a recommended decision (reported in full at 21 CCF para. 84202) holding that the decision of the first panel that there was no changed condition respecting the actual soil encountered was arbitrary and capricious; and reviewing and making recommendations respecting the acceleration claim as set forth at length in said decision. This case came before the court on plaintiff's request for review by the court of said decision, and on January 5, 1977, by order, the court adopted and affirmed the decision as the basis for its judgment in this case. Pursuant to 28 U.S.C. § 1491, as amended by Pub. L. 92–415, 86 Stat. 652, and Rule 149 of this court, the court remanded this matter to the General Services Administration Board of Contract Appeals for a period not in excess of 6 months for further consideration and amendment of its findings and decisions consistent with the said recommended decision; and the court stayed proceedings pending completion of the remand proceedings. Plaintiff's motion for rehearing *en banc* was denied May 27, 1977.

---

No. 69–73. JANUARY 5, 1977

Levi Cohen

*Civilian pay; separation; transfer of agency function; refusal to accompany position and function; procedural due process; admissibility of affidavits re motion for summary judgment.*—On January 5, 1977 the court entered the following order:

*John I. Heise, Jr.*, attorney of record, for plaintiff. *Leonard J. Meiselman*, of counsel.

*Vincent M. Garvey*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before NICHOLS, Judge, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This civilian pay case comes before the court on cross motions for summary judgment. There is no genuine issue as to any material fact.

"Prior to his separation on March 23, 1970, plaintiff was a federal employee at the Naval Applied Science Laboratory (NASL), Brooklyn, New York. By letter plaintiff was notified that his work had been identified with the function 'other electronics' being transferred to the Naval Electronic Laboratory Center (NELC), San Diego, California, and that he had a right to transfer to NELC with the function. Plaintiff was further advised that a declination of the offer to transfer would subject him to separation from employment. Plaintiff declined to transfer with his function and thereby was separated by adverse action procedures.

"Plaintiff contends that the proposed transfer of the function with which his work had been identified and which transfer plaintiff declined to accept was not a tranfer of a function at all but, rather, part of an overall reduction-in-force (RIF). Hence, plaintiff alleges that he should not have been separated by adverse action for declining to transfer with his function, but rather by RIF procedures. In addition, plaintiff contends that the agency failed to comply with its procedural regulations in removing plaintiff from his position with the Navy and that the Civil Service Commission (CSC) and the Board of Appeals and Review of the CSC (BAR) failed to give plaintiff the full benefit of procedural due process.

"Plaintiff filed suit in this court seeking back pay, restoration to his former position and correction of all applicable records. Upon consideration of the parties' briefs submitted with their respective motions and supporting documents and after oral argument by counsel, the court finds:

"(1) The CSC correctly concluded in a detailed, thorough and supported decision and the documentary evidence establishes: (a) that prior to his separation plaintiff's position was located in the Electronics Division, Systems Performance Effectiveness Branch of NASL, which division was properly identified as part of the 'other electronics' function; (b) that the function 'other electronics' was moved from NASL to NELC; (c) that such a movement of function is by definition a transfer of function and not a reorganization; (d) that plaintiff's separation was the result of his declining the offer to transfer with the function with which his work had been properly identified and was not the result of any reorganization or overall RIF.

"Plaintiff's reliance on the administrative proceedings after remand in *Shubinsky* v. *United States*, 203 Ct. Cl. 199, 488 F. 2d 1003 (1973), to support his contention that there was no valid transfer of the function 'other electronics,' but rather there was a reorganization which entitled plaintiff to RIF procedures, is completely without merit. There was no finding by the CSC after remand in *Shubinsky* that the function with which plaintiff's work was identified was not validly transferred from NASL to NELC. Rather, the CSC concluded that the actions establishing Naval Strategic Systems Navigation Facility (NSSNF) from '* * * what remained of NASL, *after certain functions had been transferred elsewhere* * * * was a reorganization and not a transfer of function.' [Emphasis supplied.] Hence, contrary to plaintiff's contentions, plaintiff and *Shubinsky* were not caught in the 'identical reorganization.' The record establishes that the function with which plaintiff's work was identified was transferred to NELC and was completely unrelated to the function proposed to be performed by NSSNF.

"(2) Plaintiff makes several allegations in his petition to the effect that the decision to remove plaintiff for declining to transfer was arbitrary and capricious and that in removing plaintiff from his position the officials at NASL failed to comply with the agency procedural regulations.

"It is well established that there is a presumption that officials act in good faith and the burden to overcome such a presumption is heavy. *Grover* v. *United States*, 200 Ct. Cl.

337, 344 (1973). Plaintiff has failed to introduce sufficient evidence to overcome this presumption. Plaintiff has failed to show that any regulation related to transfer of the function with which his work was identified was not followed. There is no evidence in the record that the transfer of the function with which plaintiff was identified was a subterfuge to deny plaintiff his retention rights. In addition, not only is there no evidence that the officials effecting plaintiff's separation did not act in good faith, all the evidence is to the contrary. Accordingly, we find that the Navy's decision to remove plaintiff from his position for declining an offer to transfer with the function with which his work was identified was for such cause as to promote the efficiency of the service, was based on substantial evidence and was neither arbitrary nor capricious. The agency did not abuse its discretion by separating plaintiff by adverse action for refusing to accompany the transfer of the function with which his work was identified. Furthermore, the record clearly establishes that the procedural requirements to accomplish the adverse action taken to remove plaintiff were fully complied with in the instant case.

"(3) Although plaintiff alleges that the CSC and BAR failed to give him the full benefit of procedural due process, plaintiff's conclusory allegations that the instant case is distinguishable from the decisions by this court in *Sullivan* v. *United States*, 189 Ct. Cl. 191, 416 F. 2d 1277 (1969), and *Terry* v. *United States*, 204 Ct. Cl. 543, 499 F. 2d 695 (1974), *cert. denied*, 421 U.S. 912 (1975), are unpersuasive. This court was confronted in *Terry* with the precise issue now presented by plaintiff and we found that the failure to allow a verbatim transcript did not constitute a denial of procedural due process if, the CSC regulations do not require a verbatim transcript, a comprehensive summary of the hearing proceedings was prepared, each party was given the opportunity to submit exceptions thereto, and such exceptions became part of the record on appeal. *Terry* v. *United States*, 204 Ct. Cl. at 555–56, 499 F. 2d at 701; *Sullivan* v. *United States*, 189 Ct. Cl. at 195, 416 F. 2d at 1280. In the instant case, the record establishes that the hearing summary was forwarded for plaintiff's comments, that plaintiff him-

self acknowledged that he submitted his comments on the summary, and that said comments were made a part of the record. Plaintiff has failed to point to any statute or regulation in effect at the time of the hearing requiring that a verbatim transcript be made. Thus, it does not appear that plaintiff's constitutional or statutory rights were violated by the procedure utilized. In addition, we do not find procedural error or denial of due process in the fact that the decision of the CSC was written by an appeals examiner other than the one who conducted the hearing. *Richman* v. *United States*, 206 Ct. Cl. 844 (1975); *Tri-Cor, Inc.* v. *United States*, 198 Ct. Cl. 187, 194–95, 458 F. 2d 112, 116 (1972). It should be noted that plaintiff has made no allegation that the appeals examiner who wrote the decision did not consider all the evidence in the record. See *Sternberger* v. *United States*, 185 Ct. Cl. 528, 537, 401 F. 2d 1012, 1017 (1968). Accordingly, plaintiff has failed to show any procedural violation with regard to the record of the CSC hearing.

"As for the other specific procedural errors alleged, we find that there was no material procedural error on the part of the CSC either by failure of the CSC to request that the Navy make certain witnesses available or by the failure of the CSC to request the Navy to produce certain documents. Defendant has fully discussed each witness and document requested by plaintiff and has established from the record that the CSC did not abuse its discretion by not requesting the Navy to produce such witnesses or documents. Plaintiff has failed sufficiently to address these arguments presented by defendant or to establish that the CSC abused its discretion.

"(4) Plaintiff has attached his own affidavit to his brief together with certain documents which do not appear as part of the certified copy of the CSC record compiled in this matter. Since the evidence presented by plaintiff's exhibits and affidavit do not constitute newly discovered evidence which would entitle plaintiff to a court trial, since this case properly submitted on motions for summary judgment can be decided on the basis of the administrative record, the use of extraneous affidavits or exhibits to supplement an administrative record is not permitted. *Shanteau* v. *United States*, 208 Ct. Cl. 983 (1976). Therefore, defendant's motion to

strike all exhibits attached to plaintiff's brief which are not part of the administrative record compiled by the CSC in this matter and not within the purview of judicial notice is granted.

"Since the administrative record compiled in this case shows that plaintiff's removal for declining to transfer with the function with which his work had been properly identified was supported by substantial evidence, was neither arbitrary nor capricious and was in compliance with all procedural requirements,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted, that plaintiff's motion for summary judgment be and is hereby denied and that the petition be and is hereby dismissed."

---

Nos. 6–74 and 7–74. JANUARY 5, 1977

Jasper Bell, et al.

Joseph Andrews, et al.

*Civilian pay; overtime pay; eating time; airport Government policemen.*—Plaintiffs, former and present policemen at either Washington National Airport or Dulles International Airport, seek overtime compensation, claiming that they were required to work 2½ hours per week in excess of the 40-hour work week prescribed by statute, due to alleged constant interruptions of their assigned 30-minute lunch periods. Plaintiffs were not required by regulation or official policy to eat their meals and spend their scheduled 30-minute meal periods on the premises where they were employed. On November 5, 1975 Senior Trial Judge Mastin G. White filed a recommended decision concluding that plaintiffs have not sustained their burden of proof by establishing, through a preponderance of the evidence, that their scheduled 30-minute meal periods were interrupted so "constantly" as to place *all* scheduled meal periods in the category of working time for which overtime compensation is due. This case came before the court on plaintiffs' exceptions to the said recommended decision. On January 5, 1977, by order, the court adopted and affirmed the said decision as the basis for its judgment in this case, concluded and ordered that plaintiffs are not entitled to recover, and dismissed the petitions.

No. 438–74. JANUARY 5, 1977

American President Lines, Ltd.

*Contracts; Merchant Marine Act; operating differential subsidy; denial of subsidy rating for Associate Chief Steward; invalidity of without hearing; remand to Board.*—On January 5, 1977 the court entered the following order:

*Robert T. Basseches*, attorney of record for plaintiff. *Shea & Gardner*, of counsel.

*John W. Showalter*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant. *Scott Blaze*, of counsel.

---

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"Plaintiff, American President Lines, Ltd., is a corporation which during the years 1957 to 1973 operated a steamship service for passengers and freight using SS PRESIDENT CLEVELAND, WILSON, and ROOSEVELT. In 1957 plaintiff entered into a contract with the United States acting through the Maritime Subsidy Board of the Department of Commerce for the purpose of obtaining an operating differential subsidy as authorized by the Merchant Marine Act of 1936, *as amended* (46 U.S.C. § 1171, *et seq.*). The Merchant Marine Act was enacted in 1936 and the parties used the section numbers of the original Act rather than the section numbers of the amended statute, and we will do the same. Section 606(1) of the Act and Article I–5(a) of the subsidy contract contain procedures by which the amount of operating subsidy is to be determined. The pertinent portions of these provisions are as follows:

> * * * [T]hat the amount of the future payments to the contractor shall be subject to review and readjustment from time to time, but not more frequently than once a year, at the instance of the [Board] or of the contractor. If any such readjustment cannot be reached by mutual agreement, the [Board] on its own motion or on the application of the contractor, shall, after a proper hearing, determine the facts and make such readjustment in the amount of such future payments as it may determine to be fair and reasonable and in the

> public interest. The testimony in every such proceeding shall be reduced to writing and filed in the office of the [Board]. Its decision shall be based upon and governed by the changes which may have occurred since the date of the said contract, with respect to the items theretofore considered and on which such contract was based, and other conditions affecting shipping, and shall be promulgated in a formal order, which shall be accompanied by a report in writing in which the [Board] shall state its findings of fact; * * *

"On March 19, 1964, the plaintiff sought approval for subsidy of a rating called "Associate Chief Steward" (ACS) on all three ships. The Board denied the approval of this subsidy without a hearing on May 16, 1967, on the ground that this position on the ships was not fair and reasonable, was not necessary for the efficient and economical operation of the ships, and was clearly improvident, unnecessary, and excessive. After the denial of the request by the Board, plaintiff requested reconsideration and filed new evidence with the Board and requested a hearing in accordance with section 606(1) of the Act quoted above. In March 1970, the Board denied the subsidy and denied plaintiff's request for a hearing. Thereafter, the Secretary of Commerce denied plaintiff's petition for review of the Board's order without opinion or comment.

"In January 1971, plaintiff and the Board entered into a series of agreements adopting the subsidy rates covering the operation of the three vessels from 1965 through 1971. However, plaintiff reserved in writing its right to a hearing under section 606(1) on the issue of applying the agreed rates to the proposed ACS rating expenses in the calculation of the subsidy. Plaintiff filed suit in this court on December 20, 1974, asking for a recovery of $326,624.53 due for the years 1963 through 1970 representing the subsidized portion of the salaries of the ACS on each of the three vessels named above, alleging that the denial by the Board of subsidy rating for these positions without a hearing was a breach of contract and a violation of the statute. The defendant has filed a motion for summary judgment asking that plaintiff's petition be dismissed, or in the alternative, that the case be remanded to the board for a further administrative hearing.

Plaintiff has filed a cross-motion for summary judgment asking that the denial of the subsidy rating for said positions be held invalid and that the case be remanded to a trial judge of this court for trial, or in the alternative, that the case be remanded to the Board for a full evidentiary hearing as contemplated by section 606(1).

"After consideration of the briefs and oral argument, we conclude that the denial of a subsidy rating for the ACS position on the three designated ships during the period in question by the Board without granting plaintiff's request for a hearing was a violation of the Act and contrary to the subsidy contract. Upon request, the Board must afford plaintiff a hearing no later than immediately following the Board's calculation of subsidy payments due. We hold that the rating denial, without a hearing, was invalid and that the case should be remanded to the Board for a full evidentiary hearing in which both parties can participate and present evidence. *See Moore-McCormack Lines* v. *United States*, 188 Ct. Cl. 644, 413 F.2d 568 (1969) and *Farrell Lines, Inc.* v. *United States*, 204 Ct. Cl. 482, 499 F.2d 587 (1974). Accordingly,

"IT IS ORDERED that plaintiff's motion for partial summary judgment declaring the denial of the rating of Associate Chief Steward invalid and defendant's cross-motion for summary judgment dismissing plaintiff's suit are denied, both without prejudice, and that plaintiff's and defendant's cross-motions for summary judgment asking that the case be remanded to the Board for a further administrative hearing are granted. That part of plaintiff's motion requesting remand to a trial judge of this court is denied.

"Pursuant to 28 U.S.C. § 1491 and Rule 149, IT IS FURTHER ORDERED that this case is remanded to the Maritime Subsidy Board and the Secretary of Commerce for a period not to exceed six months for the purpose of conducting a full evidentiary hearing in accordance with section 606(1) of the Act to determine from the facts whether or not it would be fair and reasonable and in the public interest to approve and grant a subsidy rating for the position of Associate Chief Steward on the three vessels named above during the period in question. Further proceedings in this court shall be stayed

during the period fixed by this order of remand. Defendant's counsel is designated to advise the court by letter to the Clerk of the status of the remand proceedings as provided for in Rule 149(f), with such advice to be given at intervals of 90 days or less, commencing from the date of this order. *See also* Rule 150."

---

No. 160–75. JANUARY 5, 1977

Lit-Ning Products, Inc.

*Contracts; default termination for delay; accord and satisfaction; failure to exhaust administrative remedies.*— Plaintiff seeks Wunderlich Act review of three decisions of the General Services Board of Contract Appeals, one affirming the default termination of plaintiff's contract to supply metal wastebaskets, one on reconsideration, and one on assessment of excess reprocurement costs, and seeks damages for the financial consequences of an allegedly improper fire test which is said to have temporarily prohibited further production and eventually contract termination for default in delivery. Defendant, in its cross-motion for summary judgment, justifies the default termination, relies on a defense of accord and satisfaction, and counterclaims for excess reprocurement costs, alleging a now binding election by plaintiff during administrative stages not to contest the amount of the award for excess reprocurement costs. On May 19, 1976 Trial Judge C. Murray Bernhardt filed a recommended decision (reported in full at 22 CCF para. 80311) agreeing with the Board's legal conclusion that plaintiff's claim is barred by accord and satisfaction, and further finding that plaintiff is barred from recovering for failure to exhaust administrative remedies and on the factual basis of the causes of the delay, and that the Board's assessment of excess reprocurement costs is amply supported by the record. This case came before the court on plaintiff's request for review by the court of the said recommended decision. On January 5, 1977 the court affirmed and adopted the said decision as the basis for its judgment in this case, dismissed the petition, and entered judgment for defendant on its counterclaim in the sum of $17,895.28.

242–469—78——38

No. 237–75. JANUARY 5, 1977

Helen A. Pryor

*Civilian pay; dismissal; refusal to submit to psychiatric evaluation.*—On January 5, 1977 the court entered the following order:

*Albert A. Rapoport*, attorney of record, for plaintiff.

*Richard J. Webber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on the parties' cross-motions for summary judgment. Oral argument has been had and the court has considered the briefs, exhibits, and argument. The court finds that there are no disputed issues of relevant fact requiring trial (or other further fact-finding process) and that the case is ready for disposition on the parties' motions, including the exhibits.

"Plaintiff, an employee of the Department of Defense, was removed in October 1973 for insubordination in that she had refused to submit to a psychiatric evaluation as part of a fitness-for-duty examination. On appeal to the Civil Service Commission, the employing agency's determination was affirmed by the then Appeals Examining Office and thereafter by the then Board of Appeals and Review. The gravamen of her case in this court is that she was deprived of procedural protections to which she was entitled; she also claims that there was not sufficient evidence to support the finding that she had refused to submit to a psychiatric examination. We hold these contentions to be without merit and discuss her major points.

"First, the Federal Personnel Manual expressly authorizes a demand that an employee undergo a psychiatric evaluation, and it is clear from the record as a whole that, before charging plaintiff with insubordination, the agency gave her ample and repeated opportunity to make herself available for the psychiatric examination which she knew was demanded of her. In this process she was plainly given the chance to select psychiatrists of her own choosing if she preferred not to be

examined by federal medical officers. There is more than sufficient support for the administrative finding that she knowingly and deliberately refused to cooperate at all. She even refused to submit to a psychiatric evaluation in connection with the processing of an involuntary application the agency made to the Civil Service Commission for disability retirement (on psychiatric grounds), and the application therefore had to be dismissed by the Commission. She has continued to remain adamant in her refusal to undergo a psychiatric examination.

"Second, if it is a prerequisite to such a demand (*i.e.* that the employee undergo psychiatric examination) that the agency have reason to believe that such an evaluation is appropriate or called for in determining the employee's fitness for duty, the record contains information demonstrating affirmatively that here the agency had such reason to believe. For one thing, the doctor who examined her physically reported that he had tried to convince her that talking with the staff psychiatrist would be to her advantage and added: 'My general impression is that Mrs. Pryor must have many unresolved unconscious conflicts which make her emotionally maladapted. Her thinking and judgment seems to be impaired; she is accident prone, and she appears to have false beliefs. Her attitude toward her previous accidents also includes an element of compensation neurosis.'

"Third, plaintiff contends that the agency was required to follow the requirements of Part 831 of 5 C.F.R. relating to disability retirement. We do not decide whether or not this was so because we conclude, as did the Board of Appeals and Review, that in any event the agency essentially and substantially complied with the 831 requirements before plaintiff was charged with insubordination in July 1973. Three agency officials plus two physicians (Drs. Mayer and Pease) were satisfied that a psychiatric examination was called for. Plaintiff selected a personal representative, an attorney, to advise her; this selection was made before the last requests that she cooperate in taking a psychiatric examination. She was clearly notified in advance of the scheduled examinations, and she was likewise given the right to sub-

mit the names of psychiatrists acceptable to her. She also had been given sufficient indication that there was a substantial question as to her psychiatric condition. Accordingly, there was no significant defect in the agency's procedures even if the requirements of Part 831 are applicable.

"Fourth, no material error marred the hearing or procedures of the Civil Service Commission. In upholding the finding of insubordination the Commission did not consider or rely upon the unsworn statements of federal personnel which plaintiff challenges. There is therefore no pertinence to her points that these materials found their way improperly into the administrative record and that plaintiff was not permitted to examine the employees who made the statements. *Cf. Pascal* v. *United States*, 211 Ct. Cl. 183, 189 (1976). Similarly, there was no abuse of discretion in limiting the number of witnesses; the hearing fairly ventilated the issues before the Commission. And it was not error to have the determination of the Appeals Examining Office signed by an official other than the examiner who conducted the hearing. *See Richman* v. *United States*, 206 Ct. Cl. 844, 845 (1975).

"Fifth, the sanction of removal is authorized by the Federal Personnel Manual for circumstances like those present here. Since plaintiff persisted over a long period in refusing to cooperate in any proceedings involving disability, there was no abuse of discretion in deciding that separation was the only practical remedy.

"We have also considered plaintiff's many other points but find that none of them vitiates the administrative determination or proceedings.

"IT IS THEREFORE CONCLUDED AND ORDERED that defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed."

Plaintiff's motion for rehearing *en banc* was denied February 14, 1977. Plaintiff's petition for certiorari denied October 3, 1977.

No. 365–75. JANUARY 5, 1977

Robert L. Guyler Company

*Contracts; interpretation; intention of parties.*—On January 5, 1977 the court entered the following order:

*Teairl W. Lewis*, attorney of record, for plaintiff. *Morriss, Boatwright, Lewis & Davis*, of counsel.

*Lawrence S. Smith*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on the parties' cross motions for summary judgment and involves a Wunderlich Act review of a decision rendered by the Armed Services Board of Contract Appeals. Plaintiff entered into a contract with the Government for construction of a remote transmitter and receiver facility at the Naval Air Station, Chase Field, Beeville, Texas. Included among the features to be installed under the contract was a communications duct system, and a dispute between the parties arose regarding the type of conduit required by the specifications. The facts are not in dispute, and the only issue is the proper interpretation of the specifications, which presents a question of law.

"Although the Board's decision on the legal question is not binding on the court under 41 U.S.C. § 322, the court has, after reviewing the Board's decision and the motions and briefs of the parties, concluded that the specifications were not defective; that the contractor was not required to do work in excess of the requirements of the specifications and that the Board's decision is correct as a matter of law. We reach this conclusion in following the well established rule that the intention of the parties is to be gathered from the whole instrument and that an interpretation which gives a reasonable meaning to all parts of the contract would be preferred to one which leaves a portion of it useless, inexplicable or inoperative. *See Hol-Gar Mfg. Corp.* v. *United States*, 169 Ct. Cl. 384, 351 F. 2d 972 (1965) and *Abe L. Greenberg Co.* v. *United States*, 156 Ct. Cl. 434, 300 F. 2d 443 (1962).

"IT IS THEREFORE ORDERED, that defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied and the petition is dismissed."

---

No. 283–72. JANUARY 19, 1977

The American Dredging Company

*Pleading and practice; leave to take depositions; attendance of witnesses; subpoena.*—On January 19, 1977 the court entered the following order:

*Robert E. Losch*, attorney of record, for plaintiff. *McNutt, Dudley, Easterwood & Losch*, of counsel.

*Ray Goddard*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case is before the court on defendant's request for review of the trial judge's order of December 16, 1976, denying defendant's motion, pursuant to Rule 81, for leave to take a deposition, compelled by subpoena issued by this court, of an individual believed to be a vital witness to defendant's case pending before the Corps of Engineers Board of Contract Appeals (the board). The board has scheduled a hearing for January 25, 1977. On June 30, 1975, the court remanded the case to the board for further proceedings now in progress. 207 Ct. Cl. 1010 (1975).

"Defendant represents that the witness, a resident of Charleston, South Carolina, is of advanced age, in poor health, and unwilling to permit his deposition without compulsory process. Defendant seeks to preserve his testimony for use by the board in its forthcoming determinations. The board's procedural Rule 14 permits discovery depositions, but only in situations where the deponent appears voluntarily, for the board lacks subpoena power. Defendant apparently has not asked the board for an order authorizing the deposition under Rule 14, but instead has come directly to the court, on the theory that it would be useless to invoke

Rule 14 in view of the foregoing information that the witness would not testify unless compelled to do so. To obtain its requested subpoena, defendant relies on two prior cases. *Anthony P. Miller, Inc.* v. *United States*, 191 Ct. Cl. 292, 422 F. 2d 1344 (1970), and *Aircraft Associates & Mfg. Co.* v. *United States*, 174 Ct. Cl. 886, 357 F. 2d 373 (1966), and upon Rule 27 of the F.R.C.P. The latter rule, of course, is not applicable in the Court of Claims, nor in the context of the present issue.

"In *Miller* and in *Aircraft Associates*, the clerk of the court issued a subpoena to compel the attendance of witnesses in matters before administrative boards. However, in each case this was done by agreement of the parties, whereas here plaintiff opposes the requested procedure. Further, in *Aircraft Associates*, the subpoena was issued pursuant to statute, 5 U.S.C. § 304 (1970), which allows a witness to be subpoenaed upon application to a judge or clerk of a court of the United States, but requires that the application be made in the first instance by the head of an Executive department or military department or bureau thereof in which a claim is pending. Defendant has not shown us a request for subpoena by the relevant department or bureau head.

"Defendant argues that the case is still on the court's docket, although proceeding through administrative channels, and therefore that our Rule 82(a), which can compel attendance of deposition witnesses, and Rule 123(b)(1), providing that subpoenas will be issued at the request of any party for attendance of witnesses at a hearing or trial, can be invoked to produce a witness before the board. The trial judge has held that these Rules apply only to hearings before the court, and no such hearing is pending. The court does not have a rule which explicitly covers this situation, although 28 U.S.C. § 2521 (1970) conceivably could be used as authority to make such a rule.

"The case is on our docket, but it is before the board for fact finding and may or may not return to the court. Although we recognize the importance of the issue to defendant, we must also be mindful of the statute which requires action by the head of the Executive department or bureau in which the claim is pending. We are also of the opinion that the

board is in the best position to determine whether depositions should be allowed in cases it has under active consideration. Defendant is instructed to comply with Rule 14 of the board and its other applicable rules, if any, and if it authorizes a deposition which cannot be had without subpoena, then we should be shown a request under 5 U.S.C. § 304 (1970), as was done in *Aircraft Associates*, *supra*, directed to a judge of the court or to the court's clerk, requesting that the court issue a subpoena to enforce the board order allowing the deposition. The statute does not permit Government trial counsel to speak for the officials there identified. If this is done we will at the proper time decide the matter on the papers then before us. The matter is not ripe for our action now. Nor do we rule at this time on the standing of plaintiff in this case to oppose issuance of a subpoena by this court in aid of a deposition ordered by the board.

"IT IS THEREFORE ORDERED that defendant's request for review is granted, but the relief therein requested is denied without prejudice."

---

No. 380–69. JANUARY 27, 1977

Monroe Garment Company, Inc.

On January 27, 1977 the court entered the following order:

*Edwin J. McDermott*, attorney of record, for plaintiff.

*Lawrence S. Smith*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case was previously before the court, 203 Ct. Cl. 324, 488 F. 2d 989 (1973). The court granted defendant's motion for summary judgment and remanded the case to the Armed Services Board of Contract Appeals (Board) for further proceedings to determine the amount of any equitable adjustments due the United States pursuant to the provisions of the Supply Warranty Clause of the contract. By decision of November 7, 1975, the Board determined that the sum of

$151,252.08 was due the United States. Plaintiff has not taken any exception with or filed any objection to the Board's decision.

'Defendant now moves for summary judgment in the amount found due the Government by the Board in its decision on remand. In its response to defendant's instant motion for summary judgment, plaintiff does not deny that it is indebted to the United States in the sum claimed by the Government. Therefore,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted; that judgment for the defendant against the plaintiff in the amount of $151,253.08, the amount found due the Government by the Armed Services Board of Contract Appeals in its decision November 7, 1975, ASBCA Nos. 14465, 14882, 14985, 15158, 15189, 15311 and 19273, be and is hereby entered; and that plaintiff's petition be and is hereby dismissed."

---

No. 799–71. JANUARY 27, 1977

Florence B. Fisackerly, et al.

*Eminent domain; taking; just compensation; pre-taking date compensation; flooding; crops damage.*—In March 1968, in anticipation of completion of a levee and flood-control project likely to cause plaintiffs' lands to be subject to frequent flooding, the United States filed a declaration of taking and instituted condemnation proceedings in a federal district court to acquire title to the lands, and in that proceeding plaintiffs received an award for their lands. In the present suit plaintiffs seek an additional sum for damage and destruction of their agricultural crops during 1966 and 1967, a claim which the district court held was exclusively within the jurisdiction of the Court of Claims. On August 23, 1976 Trial Judge Philip R. Miller filed a recommended decision concluding that plaintiffs on the record failed to carry their burden of proof that the Corps of Engineers was responsible for their losses. On January 27, 1977 the court entered the following order:

*W. Timothy Jones*, attorney of record, for plaintiffs *Brunini, Grantham, Grower & Hewes*, of counsel.

*Howard O. Sigmond*, with whom was *Assistant Attorney General Peter R. Taft*, for defendant.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This case comes before the court on plaintiffs' Rule 142 statement (filed November 12, 1976) of submission of the case to the court on the trial judge's report in lieu of exceptions and brief, wherein plaintiffs (without written or oral argument) urge reversal of the trial judge's report and decision, and on defendant's election (filed November 18, 1976) to submit the case without exception or brief on the trial judge's report and defendant's motion under Rules 141(b), 142 and 143(d) for adoption of the trial judge's decision and findings of fact and dismissal of plaintiffs' petition. The case has been considered, without oral argument, on these filings and on the recommended decision of Trial Judge Philip R. Miller, filed August 23, 1976, pursuant to Rule 134(h).

"It is plain that the case was presented to the trial judge without benefit of this court's recent decision in *Barnes* v. *United States*, 210 Ct. Cl. 467, 538 F.2d 865 (1976), and that the trial judge did not have adequate opportunity to take account of the impact of that ruling on the present case. We think that *Barnes* is conclusive here and that we need not delve into the difficult issues confronted in the trial judge's opinion. Assuming *arguendo* that this court is bound by the findings of the courts within the Fifth Circuit that the United States caused the destruction of the crops in 1965, 1966, and 1967, the plaintiffs still cannot recover in this suit for the value of those crops because 'at best, crop damages sustained prior to the date of taking [here, 1968] are the product of tortious invasions—mere trespasses,' and as such are not recoverable in this court. *Barnes* v. *United States*, *supra*, 210 Ct. Cl. at 482, 538 F.2d at 874. That is the narrow ground of our decision dismissing the petition.

"IT IS THEREFORE CONCLUDED AND ORDERED that plaintiffs are not entitled to recover and their petition is dismissed."

---

No. 87–74. JANUARY 27, 1977

Confederated Salish and Kootenai Tribes of the Flathead Reservation, Montana

*Indian claims; fiduciary obligation of Government to Indians; standard of care.*—The Tribes sue the United States to recover sums which the former paid to three enrolled tribal members in accordance with agreements entered into by the Tribes and the individual Indians, with the approval of the Government, for purchase by the Tribes of the Indians' interests in certain Indian trust land situated within the reservation. When the agreements were made and the money paid, the Government's land records showed that each of the three Indians held an undivided one-third interest in the beneficial ownership of the subject portion of trust land. The Tribes' theory is that the Government (acting through an Examiner of Inheritance, Department of the Interior) breached its duty by failing to meet the standard of "great care" mandated in *United States* v. *Mason*, 412 U.S. 391, 398 (1973), when it entered an order in December 1959, containing factual findings, determining that an enrolled member of the Tribes (Mrs. Ragsdale), who disappeared in late 1948, was presumed dead and that her heirs were her three children. In 1972 it was established that Mrs. Ragsdale was alive and the Tribes restored her name to the tribal roll. In 1973 the order determining the heirs was vacated and the deeds executed in favor of the Tribes were vacated. In a recommended opinion filed September 10, 1976 Senior Trial Judge Mastin G. White concluded that the Government did not breach its fiduciary duty of "great care" and that plaintiff-Tribes is not entitled to recover. This case came before the court on defendant's motion that the court adopt the recommended decision. On January 27, 1977 the court, by order, adopted the decision as the basis for its judgment in this case that plaintiff is not entitled to recover, and dismissed the petition.

No. 276–74. JANUARY 27, 1977

Central States Health &
Life Company of Omaha

*Pleading and practice; dismissal of counterclaim.*—On January 27, 1977 the court entered the following order:

*Francis M. Gregory, Jr.*, attorney of record for plaintiff. *James V. Heffernan, Carolyn P. Chiechi, David M. Flynn*, and *Sutherland, Asbill & Brennan*, of counsel.

*Bruce W. Reynolds*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"This tax case was the subject of our order of October 30, 1975, 207 Ct. Cl. 1047, in which we granted plaintiff partial summary judgment, the amount of the award to be determined under Rule 131(c). Our order provided that the determination of the amount of plaintiff's recovery would await the outcome of defendant's then pending claim for setoff against plaintiff. In our subsequent order of June 11, 1976, 210 Ct. Cl. 702, we granted plaintiff's motion to dismiss with prejudice one of its remaining claims, that is, one not the subject of the prior summary judgment. Defendant opposed plaintiff's motion to dismiss, if our granting the motion would have meant dismissing the setoff as well. We untangled this situation by granting plaintiff's dismissal, with prejudice, and determining that defendant's entitlement to setoff would not be prejudiced thereby and could still be asserted. Moreover, we granted defendant leave to amend its answer, apparently to demonstrate that the setoff was separate from plaintiff's claims.

"Defendant filed its amended answer on June 11, 1976, stating its setoff as a separate 'second defense.' Plaintiff has since moved the court to dismiss the defense, on several grounds that we have not had to reach because defendant, by its response of October 12, 1976, now states that it does not oppose plaintiff's motion to dismiss, based on the facts and circumstances of the case.

"The controversy in this case thus exhausted, the matter is ripe for disposition. Our Rule 102(e) allows us to treat dismissals of counterclaims as we do dismissals of other action. We regard plaintiff's motion to dismiss defendant's setoff claim, together with defendant's stated nonopposition as a stipulation of dismissal between the parties.

"THEREFORE IT IS ORDERED that defendant's counterclaim be dismissed, with prejudice, under Rule 102(e). Pursuant to our order of October 30, 1975, the amount of plaintiff's recovery may now be determined under Rule 131(c)."

In accordance with a memorandum report of the trial judge, the court's prior orders, and a stipulation of the parties, on February 14, 1977 the court entered judgment for plaintiff for $291,395.29, together with interest thereon as provided by law.

---

No. 153–75. JANUARY 27, 1977

Rawleigh, Moses & Co., Inc.

*Contracts; interpretation; reasonableness of interpretation.*—The question for decision in this Wunderlich Act review case is whether a firm, fixed-price contract entered into between the Defense Supply Agency and a corporation of which plaintiff is assignee required the Agency to furnish certain cotton duck, the material necessary for fabricating the contract items, fitted vehicle covers. Plaintiff maintains that the contractor interpreted the contract as requiring the Agency to supply the duck and thus its bid price, predicated on this interpretation, did not include as a factor the cost of procuring said material. The Armed Services Board of Contract Appeals denied the contractor's claim for an equitable adjustment on the ground that the contract did not require the Agency to furnish the material, and also held that, on the facts, the contractor's interpretation was unreasonable. On March 19, 1976 Trial Judge Thomas J. Lydon filed a recommended decision (reported in full at 22 CCF para. 80161) holding that the Board's decision was legally correct. This case came before the court on plaintiff's request for review by the court of the recommended decision. On January 27, 1977, by order, the court affirmed and adopted the said

recommended decision as the basis for its judgment in this case, concluded and ordered that plaintiff is not entitled to recover, and dismissed the petition.

---

No. 346–75. JANUARY 27, 1977

Wardell F. Clark

*Civilian pay; Court of Claims jurisdiction; claim for promotion based on racial discrimination.*—On January 27, 1977 the court entered the following order:

*Luther C. West*, attorney of record, for plaintiff. *West, Frame and Barnstein*, of counsel.

*Arlene Fine*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"Plaintiff, a retired GS–5 employee of the United States Coast Guard, alleges that as a result of certain racially discriminatory actions on the part of the Department of Transportation he was denied promotions and, after he instituted complaint, purposely transferred and promoted into a job he was physically unable to perform. Plaintiff seeks back pay for various periods beginning in 1961 and reinstatement in a GS–9 position.

"Plaintiff's claim for back pay for positions to which he was never promoted is based upon alleged racial discrimination against him during his employment. The court concludes that in view of the decisions of the Supreme Court in *United States* v. *Testan*, 424 U.S. 392 (1976), and *Brown* v. *General Services Administration*, 425 U.S. 820 (1976), it is without jurisdiction to consider claims for promotion based on racial discrimination. *Allison* v. *United States*, 211 Ct. Cl. 332 (1976); *Morton* v. *United States*, *ante* at 549. It is clear from the decision in *Brown*, *supra*, that any jurisdiction this court may have had over back pay claims based on racial discrimination has been divested by the Equal Employment Opportunity Act of 1972. We are not unmindful of the fact that

plaintiff does not qualify for redress under the 1972 Act. *Clark* v. *Goode*, 499 F. 2d 130 (4th Cir. 1974). However, the Supreme Court has indicated that we have never had jurisdiction to give a judgment for back pay based on positions which the claimant has never held but from which he was barred by racial discrimination. *United States* v. *Testan*, *supra*. Therefore,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted and that the petition be and is hereby dismissed."

Plaintiff's petition for ceriorari was denied October 3, 1977.

---

No. 440–75. JANUARY 27, 1977

Arthur G. and Maone Guerard

*Taxes; income tax; self-employment tax refund; timely reporting of income re social security benefits; limitations period.*—On January 27, 1977 the court entered the following order:

*August M. Van Eepoel*, attorney of record for plaintiff. *Trenam, Simmons, Kemker, Scharf & Barkin*, of counsel.

*Theodore D. Peyser*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Robert S. Watkins* and *David C. Hickman*, of counsel.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"Plaintiffs sue to recover the self-employment taxes, along with the penalties and interest thereon, that they paid as assessed under Chapter 2, sections 1401–03, of the Internal Revenue Code of 1954. Plaintiffs filed their personal income and self-employment tax returns for taxable years 1956–63, 1965, 1966, and 1968 on January 23, 1973, and paid the amount of tax indicated. Plaintiffs timely submitted their claims for refund of the self-employment taxes paid on their self-employment income, which were denied on December 19, 1973. Thereafter plaintiffs filed suit in this court.

"The self-employment tax imposed by chapter 2 is, with respect to self-employed taxpayers, analogous to the Social Security taxes withheld from the earnings of taxpayers, not self-employed, who receive wages or salaries. Self-employment income timely reported is credited to a taxpayer's Social Security records of earnings, upon which Social Security benefits are based. Generally, the greater one's recorded earnings, up to a point, the greater one's entitlement to benefits through the Social Security program. When plaintiffs filed their return in January 1973, however, more than 3 years, 3 months, and 15 days had elapsed from the end of each year for which they reported self-employment income. This time limitation is significant because section 205 of the Social Security Act, as amended, 42 U.S.C. § 405, provides that one's Social Security records may not be amended to reflect any self-employment income reported thereafter. Thus, plaintiffs are frustrated in obtaining the Social Security benefits they might otherwise have received on their self-employment income.

"Plaintiffs' first argument takes a syllogistic form. Plaintiffs rely on section 6401 of the Code for their major premise, that an overpayment is any amount of tax collected after the expiration of the properly applicable period of limitations. Plaintiffs then assert that the limitations period applicable to self-employment taxes is the same as the time limitation for amending records of earnings under the Social Security Act. Plaintiffs' minor premise is that they filed their return and paid their tax, on January 23, 1973, after the Social Security time limitation had expired. Therefore, plaintiffs conclude, their remittance constituted an overpayment of tax, a refund of which is now due them under section 6402.

"The flaw of plaintiffs' argument is not in its logic but in its law. We have no quarrel with the plaintiffs' use of section 6401, but we deny the second part of that premise, that the Social Security Act furnishes the proper limitations period. Rather, we hold that section 6401 looks for the limitations period to section 6501, which contains all the limitations periods applicable to the Internal Revenue Code. Nowhere do we find the Code suggesting that periods of limitation may be adopted from any other provision of law. Thus, the general

rule of section 6501 applies here, that taxes may be assessed and collected until 3 years from the date the taxpayers' return was due, or 3 years from the date it was actually filed, whichever is later. Completing the syllogism in this light, we find that plaintiffs' taxes were collected on the same day that plaintiffs filed their return, so that the proper limitations period had not expired. Our logic leads us to conclude that there was no overpayment.

"Plaintiffs assume that, having paid the taxes, they deserve their *quid pro quo*—increased Social Security benefits—or a refund of the taxes. Whatever the moral force of their claim, it cannot prevail here in the absence of statutory support for it. Plaintiffs' liability for self-employment taxes was absolute, and neither optional nor contingent upon their eligibility to receive increased Social Security benefits. We see no support for plaintiffs' contention that they are entitled to restitution of their taxes solely because they were so delinquent in paying the tax that collateral benefits are now lost to them.

"Accordingly, upon consideration of the pleadings, plaintiffs' motion for summary judgment and defendant's cross-motion for summary judgment, and the briefs and representations of the parties but without oral argument, IT IS ORDERED that defendant's cross-motion for summary judgment be granted, plaintiffs' motion for summary judgment be denied and the petition dismissed."

---

No. 101–76. JANUARY 27, 1977

Richard Wade

*Military pay; discharge; mental disability; correction of records; right to Board hearing; entitlement to back pay.*—On January 27, 1977 the court entered the following order:

*Roy M. Kaufman*, attorney of record, for plaintiff. *Eugene Sidney Bayer*, of counsel.

*Marc J. Fink*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before DAVIS, *Judge*, Presiding, NICHOLAS and KASHIWA, *Judges*.

"This military pay case comes before the court on defendant's motion for summary judgment and plaintiff's reply thereto. There is no genuine issue as to any material fact.

"In June 1969 plaintiff was tried and convicted by general court-martial for various violations of the Uniform Code of Military Justice while he was on active duty with the United States Army. Subsequent thereto, while the case was in appellate process, the United States Army Court of Military Review received information that substantially questioned plaintiff's sanity. A medical board was convened and on May 1, 1970, with the concurrence of the Surgeon General, it reported that plaintiff was '* * * suffering from a mental disease so as to be unable concerning the particular acts charged to distinguish right from wrong.' Defense counsel moved to set aside plaintiff's conviction and to dismiss the charges against plaintiff. Without opposition from the Government, that motion was granted on July 10, 1970. Plaintiff was thereafter separated from the service under honorable conditions with a disability rating of 30 per cent, which rating was later reduced to 10 per cent.

"Plaintiff's petition now alleges that there was insufficient evidence to support a finding of mental disability. He seeks to recover $200,000 in damages, which includes back pay, and he also requests this court to order defendant to expunge all medical reports, records and documents which show or attempt to show plaintiff as being mentally ill.

"Upon consideration of the parties' briefs, together with the exhibits attached thereto, this court determines:

"(1) An objective examination of the relevant facts of this case leads us to conclude that the decision reached by the formal Physical Evaluation Board (PEB) that plaintiff should be separated from the service with a disability rating of 10 percent was reasonable and supported by substantial evidence. Furthermore, since the said decision is not arbitrary or capricious, we affirm the PEB decision. *Furlong* v. *United States*, 153 Ct. Cl. 557, 563 (1961); *Williams* v. *United States*, 186 Ct. Cl. 611, 614, 405 F. 2d 890, 891, *cert. denied*, 396 U.S. 966 (1969).

"(2) Plaintiff's petition infers that the Army Board for Correction of Military Records (ABCMR) incorrectly denied plaintiff a hearing. However, it is clear that plaintiff has no statutory right to a hearing and that the decision as to whether a hearing is necessary is within the discretion of the ABCMR. *Armstrong* v. *United States*, 205 Ct. Cl. 754 (1974); *Newman* v. *United States*, 185 Ct. Cl. 269 (1968); *Kurfess* v. *United States*, 169 Ct. Cl. 486 (1965). In the instant case, since a full hearing had recently been held before the PEB and the transcript of that hearing was available, since the ABCMR had before it all the data submitted by all concerned parties, and since the record does not show that the ABCMR acted arbitrarily in denying the hearing, we conclude that the decision by the ABCMR to not give plaintiff a hearing was not an abuse of discretion. *Armstrong* v. *United States*, *supra* at 764; *Kurfess* v. *United States*, *supra* at 491.

"(3) Plaintiff's allegation that defendant violated a contract with plaintiff '* * * by placing him on semi-retirement with decreased income' ignores the well-established principles that '* * * common-law rules governing private contracts have no place in the area of military pay. A soldier's entitlement to pay is dependent upon statutory right.' *Bell* v. *United States*, 366 U.S. 393, 401 (1961); *Abbott* v. *United States*, 200 Ct. Cl. 384, 389 (1973), *cert. denied*, 414 U.S. 1024 (1973); *Keef* v. *United States*, 185 Ct. Cl. 454, 471 (1968); *Norman* v. *United States*, 183 Ct. Cl. 41, 49, 392 F. 2d 255, 259 (1968), *cert. denied*, 393 U.S. 1018 (1969). Thus, there is no basis whatever to plaintiff's contention that he has an independent action in this court for breach of contract. Plaintiff has no contractual claim against defendant and cannot argue that his discharge deprived him of a property interest protected by the Fifth Amendment to the Constitution. *Abbott* v. *United States*, *supra*.

"(4) Plaintiff's allegations that defendant 'wrongfully stigmatized plaintiff with a false and incorrect diagnosis of mental illness' and as a result, plaintiff was financially damaged, sound in tort and are not within the jurisdiction of this court. *Clark* v. *United States*, 198 Ct. Cl. 593, 597, 461 F. 2d 781, *cert. denied*, 409 U.S. 1028 (1972); *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F. 2d 1002 (1967).

"After considering the pleadings, each party's brief, together with the exhibits attached thereto, without oral argument, this court determines that the plaintiff's assertions of improper conduct on the part of various military officials is not well taken but, rather, that the record demonstrates that defendant carefully and fully considered plaintiff's mental condition before discharging him from the service. The record in this case shows that the PEB decision was supported by substantial evidence, was neither arbitrary nor capricious and was in compliance with all procedural requirements. Therefore,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted and that the petition be and is hereby dismissed."

Plaintiff's petition for a writ of certiorari was denied May 31, 1977.

---

No. 270–76. JANUARY 27, 1977

Raul Hinojosa

*Civilian pay; limitation of actions.*—On January 27, 1977 the court entered the following order:

*David T. Lopez*, attorney of record for plaintiff. *David T. Lopez & Associates*, of counsel.

*Vincent M. Garvey*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before DAVIS, *Judge*, Presiding, NICHOLS and KASHIWA, *Judges*.

"Defendant moves for dismissal of the petition in this civilian pay case on the jurisdictional ground that plaintiff did not file the suit within six years of the accrual of his claim, as required by 28 U.S.C. § 2501. Plaintiff's employment in the Department of Agriculture was terminated on July 11, 1969. He pursued an administrative remedy on grounds of racial discrimination, and a decision of the Civil Service Commission Board of Appeals and Review, dated June 9, 1970, adverse to him, reflects the final exhaustion of administrative remedies. He filed the suit here on July 6, 1976. Plaintiff has

not responded to the motion and any response would now be out of time. Therefore, we have nothing before us to suggest the existence of any tolling period, even such a brief one as would suffice under the facts stated.

"Accordingly, upon consideration of the petition, the motion, and the supporting document, but without oral argument, it is ORDERED

"that the defendant's motion is granted and the petition is dismissed."

---

No. 380–76. JANUARY 27, 1977

George Aris Harrison

*Civilian pay; Court of Claims jurisdiction; injunctive or declaratory relief.*—On January 27, 1977 the court entered the following order:

*George Aris Harrison, pro se*

*James F. Merow*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

---

Before DAVIS, *Judge*, Presiding, and NICHOLS, and KASHIWA, *Judges*.

"In 1950 plaintiff, an employee of the Federal Government, received a judgment (on stipulation) from this court for an improper separation in 1947. *See* 117 Ct. Cl. 814 (1950). At the time of that separation he received a lump sum for his then accumulated annual leave. On his reinstatement he was required to refund only part of that lump sum. He has apparently continued in federal service and is now employed by the Agency for International Development (AID). In his current petition he asks that his present employer (AID) be required to bill him (at 1947 salary rates) for the portion of his annual leave payment which he was not required to refund on his reinstatement, and that, after he has made the necessary refund, the days represented by that payment (said to be 55 days) be restored to his annual leave account as of the present time.

"The defendant moves to dismiss the petition for failure to state a claim within the jurisdiction of this court. That

challenge is clearly correct. Plaintiff makes no claim for a money judgment against the United States for any sum now due him. Instead he asks for a combination of mandatory and declaratory relief which is outside this court's jurisdiction. *United States* v. *King*, 395 U.S. 1 (1969); *United States* v. *Testan*, 424 U.S. 392, 397–98 (1976).

"IT IS THEREFORE ORDERED AND CONCLUDED that the defendant's motion to dismiss the petition is granted and the petition is dismissed."

# JUDGMENT ORDERS

ELDON E. BAUER *v.* THE UNITED STATES

No. 102–74

[211 Ct. Cl. 276, 543 F. 2d 142]

On November 5, 1976 the court ordered that judgment be entered for plaintiff in the sum of $882.37, plus interest as provided by law.

FREDERICK H. VOGT *v.* THE UNITED STATES

No. 427–74

[210 Ct. Cl. 246, 537 F. 2d 405]

On November 5, 1976 the court ordered that judgment be entered for plaintiff in the amounts of $246.02, plus interest as provided by law, for the year 1969 and $121.36, plus interest as provided by law, for the year 1970.

CUSHING STONE COMPANY, INC. *v.* THE UNITED STATES

No. 419–70

[210 Ct. Cl. 62, 535 F. 2d 27]

On December 17, 1976 the court ordered that judgment be entered for plaintiff in the amount of $62,697.24, plus interest as allowed by law.

EASTMAN KODAK COMPANY *v.* THE UNITED STATES

No. 517–71

[209 Ct. Cl. 365, 534 F. 2d 252]

On December 17, 1976 the court entered judgment for plaintiff in the principal sum of $185,001, plus assessed interest

thereon of $53,650.29, for a total of $238,651.29, plus interest thereon as provided by law.

---

GEORGE W. WRIGHT *v.* THE UNITED STATES

No. 61-74

[205 Ct. Cl. 831]

On December 17, 1976 the court entered judgment for plaintiff in the sum of $4,937.40 pursuant to a stipulation of the parties.

---

UNITED STATES FIDELITY & GUARANTY COMPANY; AND WILLIAM GREEN CONSTRUCTION COMPANY, INC. *v.* THE UNITED STATES

No. 373-76

On January 27, 1977 the court entered judgment for plaintiffs in the sum of $125,000 after defendant's filing on January 12, 1977 of admission of liability.

# REPORT OF DECISIONS

## OF

## THE SUPREME COURT

## IN COURT OF CLAIMS CASES

---

Action was taken by the United States Supreme Court on the parties' petitions for writs of certiorari as follows:

| Petitioners | Ct. Cl. | F. 2d | Supreme Court Denied |
|---|---|---|---|
| George B. Forster, et al<br>No. 181–75 | 209:733 | ---------- | 429 U.S. 921<br>Nov. 1, 1976 |
| Sun Shipbuilding & Dry Dock Co. No. 61–73 | 210:680 | ---------- | 429 U.S. 977<br>Nov. 29, 1976 |
| Albert C. Homey<br>No. 187–74 | 210:332 | 536:360 | 429 U.S. 984<br>Nov. 29, 1976 |
| DIZ Livestock Co., et al<br>No. 95–75 | 210:708 | ---------- | 429 U.S. 1023<br>Dec. 13, 1976 |
| Frank A. Ramirez<br>No. 312–75 | 210:537 | 538:888 | 429 U.S. 1024<br>Dec. 13, 1976 |
| Russell Corp<br>No. 64–73 | 210:596 | 537:474 | 429 U.S. 1073<br>Jan. 25, 1977 |
| | | | Dismissed |
| Hopi Tribe<br>App. No. 13–74 | 208:1027 | ---------- | 429 U.S. 1030<br>Dec. 21, 1976 |

MISSING PAGES ARE INDEX PAGES
WHICH HAVE BEEN PHOTOGRAPHED
AT THE BEGINNING OF THE VOLUME(S)